No. 12338

In The United States Court of Appeals
For the Ninth Circuit

NORTHWESTERN MUTUAL FIRE ASSOCIATION,
Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Appellee.

UPON APPEAL FROM THE TAX COURT OF THE UNITED STATES

APPELLANT'S OPENING BRIEF

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Section C

JURISDICTION OF THE TAX COURT AND THIS COURT

This action was commenced October 14, 1947, by appellant filing a petition in the Tax Court of the United States (Tr. 2, 4) wherein appellant, Northwestern Mutual Fire Association, a corporation under the laws of the State of Washington, was Petitioner and the Commissioner of Internal Revenue was respondent. The purpose of that action was to obtain a refund of $21,037.86 of appellant's income tax paid for the years 1942 and 1943; and to set aside deficiency assessments by the Commissioner of Internal Revenue for said years in the amount of $10,436.84 (Tr. 5).

The statutory provisions believed to sustain the jurisdiction of the Tax Court of the United States are Title V, ch. 619, §504(a), (c), 56 Stat. at L. 957, 26

U.S.C.A. 411, §1101; Title I, ch. 619, §168(a), 56 Stat. at L. 876, 26 U.S.C.A. 126, §272(a).

On March 30, 1949, the Tax Court rendered its decision and entered judgment denying appellant a refund and asserting deficiencies in its income tax in 1942 and 1943 in the respective amounts of $5,089.03 and $5,347.81 (Tr. 3, 66). An appeal therefrom was taken by appellant by Notice of Appeal filed on June 24, 1949 (Tr. 3, 67) .

The statutory provision believed to sustain the jurisdiction of this court is Title V, ch. 619, §504(a), (c), 56 Stat. at L. 957; 26 U.S.C.A. 514, §1141(a), (b).

It is well established that where the meaning of a statute of general application is involved and where there has been a failure of the Tax Court to apply correctly the law and regulations thereunder, questions are raised which are reviewable by this court.

Dobson v. Commissioner (1943) 320 U.S. 489, 492, 88 L. ed. 249, 64 S. Ct. 239, 31 A.F.T.R. 773;

Bingham Trust v. Commissioner (1944) 325 U.S. 365, 370, 371, 89 L. ed. 1670, 65 S. Ct. 1232, 33 A.F.T.R. 842;

Commissioner v. Wilcox (1945) 327 U.S. 404, 410, 90 L. ed. 752, 66 S. Ct. 35, 34 A.F.T.R. 811;

Commissioner v. Swent (4th C.C.A. 1946) 155 F.(2d) 513, 514, 34 A.F.T.R. 1376;

Mutual Fertilizer Co. v. Commissioner (5th C.C.A. 1947) 159 F.(2d) 470, 471, 35 A. F.T.R. 792;

Kimbrell's Home Furnishings, Inc. v. Commissioner (4th C.C.A. 1947) 159 F.(2d) 608, 610, 35 A.F.T.R. 824.

Section D

STATEMENT OF THE CASE

This case involves a dispute between appellant and Appellee over the interpretation and application of subsections (h) and (b) Section 131 of the Internal Revenue Code as amended in 1942.

Appellant claims that under the provisions of these sub-sections it is entitled to a foreign tax credit for 1942 in the amount of $15,272.16, whereas for that year the Commissioner of Internal Revenue [hereinafter referred to as the Commissioner] asserts a deficiency in the amount of $5,089.03. For 1943 appellant claims a foreign tax credit in the amount of $16,202.54, whereas for that year the Commissioner asserts a deficiency of $5,347.81.

Appellee's reasons for disallowing the foreign tax credit claimed by appellant and asserting the deficiencies are stated in the deficiency notice as follows:

> "The foreign tax credits claimed in your income tax returns for the calendar years 1942 and 1943 in the respective amounts of $5,076.60 and $5,339.84 as income taxes paid to the Dominion of Canada have been disallowed for the reason that the stated taxes do not constitute 'income, war profits, or excess profits taxes paid in lieu of a tax upon income, war profits or excess profits otherwise generally imposed' by Canada. The evidence indicates that the taxes in question were in the nature of an excise imposed

under the Special War Revenue Act of Canada, and therefore do not meet the requirements of Section 131 of the Internal Revenue Code in respect to allowable credits.

"For the stated reason it has been determined also that your claim for refund in the respective amounts of $10,183.13 and $10,854.73 should be disallowed for the years 1942 and 1943. The claims for refund are disallowed on the additional ground that a proper application of the provisions of Section 131 of the Internal Revenue Code negatives the use of investment income as the basis for computing the limitation factor provided for under sub-section (b) thereof, in the case of a mutual insurance company (other than life or marine) paying a tax based upon 'the gross amount of income' as defined in Section 207 of the Internal Revenue Code." (Tr. 16, 17)

By appropriate assignments of error the appellant contested the Commissioner's ruling and interpretation of sub-sections (b) and (h) of Section 131 I.R.C. for the reason that: The taxes paid by appellant to the Dominion of Canada under the provisions of the Special War Revenue Act of Canada as amended constituted "* * * taxes paid in lieu of a tax on income, otherwise generally imposed" by Canada within the meaning of Section 131(h) I.R.C. (Tr. 5).

Appellant contends that it is entitled to the entire amount of the foreign tax credit claimed because a proper application of the provisions of Section 131(b) of the Internal Revenue Code requires the use of its normal-tax net income as the basis for computing the limitation factor provided for in that section.

The only dispute between appellant and appellee being over the interpretation of the law, they agreed to submit the case to the Tax Court upon a stipulation of facts with joint exhibits attached thereto (Tr. 24-42). The case was heard before the Tax Court on May 17, 1948, at which time oral arguments were waived and the stipulation of the parties was filed (Tr. 2, 43-47). Appellant and appellee having submitted briefs the Tax Court rendered its decision on March 30, 1949, Judge Van Fossen dissenting. The decision was entered on the same date (Tr. 3, 48-66). In its decision the Tax Court followed the Commissioner's interpretation of Section 131(h) I.R.C. in every respect, holding that the taxes paid by the appellant under the provisions of the Canadian Special War Revenue Act as amended were not taxes paid "in lieu of" a tax on income within the meaning of that section. Having decided against the appellant on that question the Tax Court did not express an opinion regarding the Commissioner's interpretation of subsection (b) of Section 131 I.R.C. (Tr. 65, 66).

Appellant served and filed timely notice of appeal from the decision of the Tax Court (Tr. 3, 67-71). The Tax Court adopted the stipulation of facts and joint exhibits (Tr. 24, 42) as their findings of fact (Tr. 50). The pertinent facts may be summarized as follows (Tr. 50-58):

Appellant is a mutual fire insurance corporation organized and operating under the laws of the State of Washington and is duly authorized and engaged in the business of writing insurance against the perils of fire and allied lines in all states of the United

States and in Canada, with its principal office in Seattle, Washington. Its income tax returns for the years 1942 and 1943 were prepared on the accrual basis and were filed with the Collector of Internal Revenue for the District of Washington at Tacoma, Washington, within and under extensions of time allowed by the Commissioner (Tr. 24, 50).

In 1942 and 1943 the appellant paid to the Dominion of Canada amounts in Canadian funds equivalent to $15,272.16 and $16,202.54 respectively in United States funds in taxes in accordance with the provisions of the Canadian Special War Revenue Act of 1915 as amended in 1942 (Tr. 29, 50). That tax was based upon the "net premiums" of appellant on its business in Canada and for those years the tax rate applicable to appellant was 3% (Tr. 29, 50).

In appellant's returns for the years 1942 and 1943 it claimed foreign tax credits in the respective amounts of $5,076.60 and $5,339.84 (Tr. 26, 51). It filed timely claims for refunds claiming additional foreign tax credits in the respective amounts of $10,183.13 and $10,854.73 for 1942 and 1943 (Tr. 26, 27).

Appellant's gross amount of income for the years 1942 and 1943 from all sources was $6,716,320.72 and $7,045,067.97 respectively, and its gross amount of income from sources in the Dominion of Canada (converted to U. S. funds) was $507,681.54 and $533,987.07 respectively (Tr. 28, 51).

In 1942 and 1943 appellant's normal-tax net income from all sources was $126,451.85 and $151,828.23 respectively, while for those years appellant's normal-

tax net income from sources in the Dominion of Canada (converted to U. S. funds) was $37,843.46 and $40,943.06 respectively (Tr. 27, 52).

During 1942 and 1943 appellant was not liable to tax on its net income from Canadian business under the provisions of the Canadian Income War Tax Act of 1917 as amended by Chapter 97, the provisions of which are set forth in the revised statutes of Canada of 1927 (Tr. 28, 52).

Prior to 1942 the appellant was required by the provisions of the Special War Revenue Act of 1915 to pay to the Dominion of Canada a tax of 1% on its net premiums from its business within the Dominion of Canada (Tr. 32, 53).

In 1942 the Dominion of Canada amended the Special War Revenue Act of 1915 by the enactment of Chapter 32 of the statutes of 1942 (Tr. 32, 53) increasing the tax on all fire insurance companies doing business in Canada, including the appellant, and the basis for said tax was the "net premiums" of said companies from their business within the Dominion of Canada. For all mutual fire insurance companies, such as the appellant, not subject to taxation on their net income under the provisions of the Canadian Income War Tax Act of 1917, the rate was increased from 1% to 3%. For all fire insurance companies which were subject by Canadian law to taxation on their net income under the Income War Tax Act of 1917 (which did not include this appellant) the rate was increased from 1% to 2% (Tr. 33, 53).

In 1946 the Canadian revenue measures were revised and the Income War Tax Act originally enacted

in 1917 was amended so that mutual fire insurance companies, such as appellant (excepting only those mutual fire insurance companies deriving their premiums wholly from the insurance of churches, schools or other religious, educational or charitable institutions), were made subject to the general income tax law of Canada (Tr. 36, 54). Prior to the enactment in 1946 of the above amendment to the Income War Tax Act of 1917 mutual fire insurance companies such as appellant were not liable to tax under the provisions of the Income War Tax Act of 1917 (Tr. 28, 55) (Appendix No. XIX).

Concurrent with the change in 1946 in the Income War Tax Act of 1917 the Special War Revenue Act of 1915 was amended further changing the name of the act from "Special War Revenue Act" to the "Canadian Excise Tax Act," and said amendment further provided that the rate of tax upon the net premium for mutual fire insurance companies such as appellant should be reduced from 3% to 2% (Tr. 38, 55).

In 1942 and 1943 the taxes imposed under the Special War Revenue Act of 1915 as amended, and the Income War Tax Act of 1917 as amended, were paid to the Minister of National Revenue, sometimes referred to as the Minister of Finance (Tr. 35, 56).

In 1942 and 1943 the administrative details of collection and auditing of taxes payable by insurance companies under the Special War Revenue Act of 1915 as amended, and the auditing of income tax returns of insurance companies which were subject to the provisions of the Income War Tax Act as amended were handled by the Department of Insurance (Tr. 35, 56).

In 1942 and 1943 the details of collection and auditing of taxes other than taxes on insurance companies payable under the Special War Revenue Act of 1915 as amended, and the general administration and the auditing of returns of taxpayers other than insurance companies under the Income War Tax Act of 1917, were handled by the Department of National Revenue (Tr. 35, 56).

In its returns for the years 1942 and 1943 and in the statement in support of credit for the foreign tax paid (Form 1118) for those years, appellant computed its foreign tax credit on the basis of its gross amount of income for each year (which constituted its taxable income under the statute). On that basis using the ratio of the total gross income from Canada ($507,-681.54) for 1942, and $533,987.07 for 1943) to total gross income in its returns from all sources for those years ($6,715,077.99 for 1942 and $7,044,271.09 for 1943) the amounts of the credits so computed were $5,076.60 and $5,339.84 for the years 1942 and 1943, respectively. The appellee disallowed the credits claimed by appellant in appellee's deficiency notice (Tr. 16, 17, 57).

In its claims for refunds for 1942 and 1943 and the statements in support of credit for foreign taxes attached thereto, appellant claimed that the credit for each year should be computed upon the basis which the ratio of the "normal-tax net income" from sources in Canada bears to the "normal-tax net income" from all sources. On that basis using the ratio which its normal-tax net income of $37,843.46 from Canadian sources bears to the "normal-tax net income" of $126,-

451.85 from all sources for 1942, and the ratio which its "normal-tax net income" of $40,943.06 from Canadian sources bears to "normal-tax net income" of $151,828.23 from all sources for 1943, the allowable foreign tax credit amounts to $15,272.16 and $16,-202.54 for 1942 and 1943, respectively (Tr. 12, 41, 57).

The appellee denied appellant's claim for foreign tax credit and appellant's claim for refund of taxes paid on two grounds. First, on the ground that the taxes paid by it to the Dominion of Canada under the provisions of the Special War Revenue Act of Canada were not taxes paid "in lieu of a tax on income" within the meaning of Section 131(h) I.R.C. Secondly, on the ground that the provisions of Section 131(b) I.R.C. negatives the use of "normal-tax net income" as the basis for computing the limitation factor provided for in said section in the case of a mutual insurance company (other than life or marine) such as appellant, paying a tax based upon "the gross amount of income" as defined in Section 207 I.R.C. (Tr. 16, 17, 49).

The Tax Court held that the tax paid by the appellant to the Dominion of Canada under the provisions of the Special War Revenue Act were not taxes paid "in lieu of a tax on income" within the meaning of Section 131(h) I.R.C., and did not express an opinion regarding the interpretation of the limitation feature of Section 131(b) I.R.C. (Tr. 65, 66).

On this appeal, therefore, the following questions are presented. (1) whether appellant is entitled to a

foreign tax credit under the provisions of Section 131(h) I.R.C. on account of taxes paid by it to the Dominion of Canada for the years 1942 and 1943 under the provisions of the Canadian Special War Revenue Act of 1915 as amended? The Tax Court answered this question in the negative (Tr. 58, 65), (2) whether the limitation upon the amount of appellant's foreign tax credit under the provisions of Section 113(b) IR..C., is measured by the ratio of appellant's "normal-tax net income" from Canadian sources to "normal-tax net income" from all sources? Having answered the first question in the negative the Tax Court declined to answer this question. Appellant contends that both of the above questions should be answered in the affirmative (Tr. 58, 65).

Section E

SPECIFICATION OF ERRORS

It is respectfully submitted that the Tax Court erred in the following particulars:

I.

In deciding that appellant was not entitled to the foreign tax credit claimed under the provisions of Section 131(h) I.R.C.

a. In failing to allow appellant foreign tax credits of $15,272.16 for 1942, and $16,202.54 for 1943.

b. In failing to allow appellant refunds of over payments of income taxes in the amounts of $10,183.13 for 1942, and $10,854.72 for 1943.

c. In deciding that appellant was liable for deficien-

cies in its income taxes for the years 1942 and 1943 in the respective amounts of $5,089.03 and $5,347.81.

II.

In failing to decide that Section 131(b) I.R.C. required the limitation of appellant's foreign tax credit to be calculated on the basis of the ratio of its "normal-tax net income" from Canadian sources to its "normal-tax net income" from all sources, and that said subsection did not limit the amount of tax credit claimed by appellant.

Section F

ARGUMENT

Summary of Argument

The Tax Court denied appellant's foreign tax credit claim holding that the tax paid by it to the Dominion of Canada in 1942 and 1943 under the Canadian Special War Revenue Act was not a "tax in lieu of * * * an income tax otherwise generally imposed" within the meaning of Section 131(h) I.R.C. It did not discuss the application of Section 131(b) I.R.C.

Appellant's principal argument under Section F of its brief is that the tax paid by it to Canada in 1942 and 1943 was a tax paid "in lieu of a tax on income otherwise generally imposed by a foreign country" within the meaning of Section 131(h). In support of its contention the literal meaning of Section 131(h) I.R.C. is discussed in Part I. The Commissioner's Regulation applicable to that section is discussed in Part II. Parts III and IV deal with the intent of Congress and the Canadian Parliament in that order, and each shows that it supports appellant's contention. In Part

V all pertinent rulings by the Commissioner are considered, and in Part VI the applicable cases, including the Tax Court's decision in this case, are analyzed showing how they support appellant's contention.

Appellant's argument under Section G of its brief deals with the interpretation and application of Section 131(b) I.R.C. The literal meaning of Section 131(b) I.R.C. is considered in Part I of that section. The applicable regulation of the Commissioner is discussed in Part II. Part III contains an explanation of that section and that regulation as applied to appellant. Part IV demonstrates that a literal interpretation of its terms is the only permissible construction of Section 131(b).

I.

According to the Literal Meaning of Section 131 (h) I.R.C. Appellant Is Entitled to the Foreign Tax Credit Claimed.

Section 131 of the Internal Revenue Code provides as follows:

> Sec. 131. *Taxes of Foreign Countries and Possessions of the United State.*
>
> "(a) Allowance of Credit:—If the taxpayer chooses to have the benefit of this section, the tax imposed by this chapter, except the tax imposed under section 102, shall be credited with:
>
> "(1) Citizens and domestic corporations — In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, or excess-profits tax, paid or accrued during the taxable year to any foreign country or to any possession of the United States:
>
> * * * * * * * * *

"(h) Credit for Taxes in Lieu of Income, etc., Taxes—*For the purposes of this section* and section 23(c)(1), *the term 'income, war-profits,* and excess-profits *taxes,' shall include a tax paid in lieu of a tax on income,* war-profits, or excess-profits *otherwise generally imposed by any foreign country* or by any possession of the United States." (Italics our) (See Appendix No. I)

The above quoted portions of Section 131 I.R.C. were applicable as quoted to the tax years 1942 and 1943 and were the sections under which the appellant claimed foreign tax credits.

Sub-section (h) above quoted was added to Section 131 of the Internal Revenue Code by Section 158(f) of the Revenue Act of 1942. Section 101 of the 1942 act makes this amendment applicable to the taxable years beginning after December 31, 1941.

For the tax years 1942 and 1943, appellant paid to the Dominion of Canada amounts in Canadian funds equivalent to $15,272.16 and $16,202.54, respectively in United States funds as taxes under the provisions of the Canadian Special War Revenue Act of 1915 as amended in 1942 (Tr. 29, 50). For those years appellant was exempt by law from paying, and did not pay to the Dominion of Canada any income tax under the provisions of Canada's Income War Tax Act, which was an income tax act generally imposed by Canada on other non-exempt corporations and individuals (Tr. 33, 52, 53).

It is conceded that Canada is a "foreign country" within the meaning of that term as used in Section 131(h) I.R.C.

Appellant contends that the taxes above referred to which were paid by it to the Dominion of Canada were taxes paid "in lieu of a tax on income otherwise generally imposed by any foreign country" within the meaning of Section 131(h) I.R.C. The appellee contends that the taxes referred to above were not taxes paid "in lieu of" a tax on income otherwise generally imposed.

Manifestly, since there is no dispute on the facts, it is necessary to interpret and construe the "in lieu of" provision of Section 131(h). In doing so it is necessary to employ the recognized rules of construction applied by the courts in interpreting and construing tax statutes of the United States. The following rules of construction are pertinent:

1. The intention or purpose of Congress in enacting or amending the particular law under consideration should be ascertained and the statute or amendment under consideration should be construed in such a way as to achieve and not defeat the aim or object of the enactment or amendment.

> *Blake v. National City Bank of New York* (1875) 90 U.S. 119, 23 L. ed. 307, 2 A.F. T.R. 2339;
>
> *Burnet v. Chicago Portrait Co.* (1932) 285 U.S. 1, 76 L. ed. 587, 10 A.F.T.R. 800.

2. Tax statutes should be construed so as not to extend their provisions by implication beyond the clear import of the language used, but in cases of doubt the statutes are construed most broadly against the government and in favor of the citizen.

Gould v. Gould (1917) 245 U.S. 151, 152, 62 L. ed. 211, 213, 3 A.F.T.R. 2958.

3. Where a statute was passed for a remedial purpose it should be liberally construed in the taxpayer's favor.

United States v. Merriam (1923) 263 U.S. 179, 187, 68 L. ed. 240, 244, 29 A.L.R. 1547, 44 S. Ct. 69, 4 A.F.T.R. 3673;

Bonwit Teller & Co. v. United States (1930) 283 U.S. 258, 263, 75 L. ed. 1018, 1021, 9 A.F.T.R. 1421;

Kimbrell's Home Furnishings, Inc. v. Commissioner (1947, 4th C.C.A.) 159 F.(2d) 608, 610, 35 A.F.T.R. 824.

4. Where the meaning of particular words used in a tax statute are in doubt, the words should be construed according to their literal and popular meaning.

Maillard v. Lawrence (1853) 16 How. (U.S.) 251, 261, 14 L. ed. 925, 930;

United States v. Merriam (1923) 263 U.S. 179, 187, 68 L. ed. 240, 244, 29 A.L.R. 1547, 44 S. Ct. 69, 4 A.F.T.R. 3673;

Crooks v. Harrelson (1930) 282 U.S. 55, 75 L. ed. 156, 9 A.F.T.R. 571;

Deputy v. DuPont (1940) 308 U.S. 488, 84 L. ed. 417, 23 A.F.T.R. 808.

With these rules of construction in mind it is pertinent to inquire what is the literal, ordinary, popular meaning of the phrase "in lieu of." "In lieu of" as used in this section must mean "in place of" or "instead of" because that is the literal meaning of the

phrase as defined in the Century Dictionary, Funk & Wagnells New Standard Dictionary and Webster's New International Dictionary (second edition) unabridged and as it is employed in the case of

State v. Minneapolis St. L. R. Co. (1939) 283 N.W. 244.

According to the literal meaning of the language employed in Section 131(h), for the appellant to be entitled to a foreign tax credit, it must appear that the tax paid by it to Canada was a *tax paid "in place of" or "instead of" a tax on income otherwise generally imposed* by Canada. It *does not* require (as the Commissioner's deficiency notice states) that the tax must constitute "income * * * taxes paid in lieu of a tax upon income * * * otherwise generally imposed by Canada." Was the tax paid by appellant *"a tax paid in place of a tax on income otherwise generally imposed" by Canada?* During 1942 and 1943 Canada had a tax on income which was generally imposed upon corporations (Tr. 35, 36, 37, 54). Appellant was specifically exempt from the tax on income generally imposed upon other corporations (Tr. 28, 29, 52, 53). "Instead of" paying a tax to Canada under the provisions of the general income tax statute appellant paid a tax at the rate of 3% upon its net premium income under the provisions of the Special War Revenue Act (Tr. 29, 50). According to the non-technical, literal and popular meaning of the language employed in Section 131(h), the tax paid by appellant to the Dominion of Canada was a tax paid "in lieu of," "in place of," or "instead of" a tax on income otherwise generally imposed by Canada.

II.

According to the Commissioner's Regulations Interpreting Section 131 (h) I.R.C., Appellant Is Entitled to the Foreign Tax Credit Claimed.

After the passage of the Revenue Act of 1942 the Commissioner promulgated Regulation 103, Section 19.131.2 (Appendix No. X). In the Commissioner's own interpretation of Section 131(h) he states:

> "For the purpose of Section 131 * * * the term 'income * * * taxes includes * * * a tax imposed by statute * * * by a foreign country * * * if (a) such country * * * has in force a general income tax law; (b) the taxpayer claiming the credit would in the absence of a specific provision applicable to such taxpayer be subject to such general income tax, and (c) such general income tax is not imposed upon the taxpayer, thus subject to such substituted tax'." (Appendix No. X)

Significantly, the Commissioner indicates in his regulation that an "in lieu of" tax could be expected to be imposed where the ascertainment of "net income," though not the determination of "gross income" from sources in the foreign country was found administratively difficult.

That it is equally as difficult in Canada as in the United States to ascertain the "net income" of a mutual insurance company is obvious. The report of the U. S. Senate Committee on Finance in discussing its attempt to formulate an income tax law applicable to mutual insurance companies such as the appellant to be incorporated in the Revenue Bill of 1942 stated, in part, as follows:

> "Your committee carefully considered the House Bill plan and various modifications of it in an attempt to define and tax underwriting income in an equitable manner. No adequate method to accomplish this result was developed. * * *" (See Appendix No. XIV)

The ascertainment of "net income" of mutual insurance companies was so difficult in our own country that provision was made in Section 207 I.R.C. to tax them on substantially a "gross income" basis. (Appendix Nos. II and XIV)

Under these circumstances it is not surprising that at the same time in Canada, appellant was subject, under the Special War Revenue Act, to a tax of 3% on its net premiums, which is, in effect, a tax on the basis of "gross income." Because of the administrative difficulty of ascertaining "net income" of mutual insurance companies such as appellant there was, in Canada, as in the United States, the same reason for a tax on mutual insurance companies such as appellant "in place of" a tax on their "net income."

Appellant does not question the validity of Commissioner's regulation. It is a correct interpretation of Section 131(h) I.R.C.. Appellant asks only that the terms of that regulation be properly applied to the facts of this case. What are the facts? Compare the requirements of the Commissioner's regulation and the pertinent facts of this case. The Commissioner's regulation requires:

(a) That such foreign country has in force a general income tax law:

During 1942 and 1943 Canada had in force a general income tax law (Tr. 35, 36, 54).

(b) That the taxpayer claiming the credit would in the absence of a specific provision applicable to such taxpayer be subject to such general income tax:

Appellant, the taxpayer in this case, in the absence of a specific provision applicable to it would have been subject to the general income tax law of Canada during 1942 and 1943 (Tr. 28, 29, 35, 36).

(c) That such general income tax was not imposed upon the taxpayer thus subject to such substituted tax:

Such general income tax law was not imposed upon the appellant taxpayer, thus subject to such substituted tax (Tr. 28, 29, 52, 53).

Appellant was subject to and did in fact pay a substituted tax of 3% on its net premiums in Canada, which amounted to $15,272.16 in U. S. funds for 1942 and $16,202.54 in U. S. funds for 1943 (Tr. 29, 50).

Having complied with the conditions precedent specified by the Commissioner in his regulation interpreting the provisions of Section 131(h) I.R.C., appellant is entitled to foreign tax credits in the above amounts as claimed.

III.

Construing the Provisions of Section 131 (h) I.R.C., According to the Intent of Congress, Appellant Is Entitled to the Foreign Tax Credit Claimed.

(a)

The early historical background of the foreign tax credit section of the U. S. Internal Revenue Code indicates Congress intended to permit a foreign tax credit under the circumstances of this case.

Appellee concedes that Section 131(h) must be construed to accomplish the result intended by Congress in adding sub-section (h) to Section 131 I.R.C. Appellant believes that to ascertain the true intent of Congress requires a thorough understanding of the historical background of the foreign tax credit section of the U. S. Internal Revenue Code.

Prior to the enactment of the Sixteenth Amendment to the Constitution of the United States the Supreme Court of the United States held the income tax law of 1895 (28 Stat. at L. 509) unconstitutional.

> *Pollock v. Palmer's Loan & Trust Co.* (1895) 157 U.S. 429, 39 L. ed. 759, 15 S. Ct. 673, 3 A.F.T.R. 2557.

A lucrative source of revenue was thus denied to the government because of the direct tax and apportionment features of Article I, Section 2, Clause 3, and Article I, Section 9, Clause 4 of the Constitution. Faced with this problem Congress enacted the Tax Act of August, 1909 (36 Stat. at L. 11, §112-117, Chapter 6, U. S. Comp. Stat. Supp. 1909, Pages 659, 844, 849) providing that insurance companies and all cor-

porations, joint stock companies or associations organized for profit and having a capital stock represented by shares should be subject annually to a special excise tax for the privilege of doing business at the rate of 1% of their net income in excess of $5,000.00, subject, however, to certain credits and deductions. A deduction from gross income was allowed to the corporation for all sums paid by it within the year for taxes imposed by the government of any foreign country as a condition to carrying on business therein (36 Stat. at L. 113, Chapter 6). In the case of *Flint v. Stone Tracy Company* (1911) 220 U.S. 107, 55 L. ed. 389, 31 S. Ct. 342, 3 A.F.T.R. 2834, the Supreme Court of the United States held that this tax was an excise tax and therefore constitutional. This was prior to the adoption of the Sixteenth Amendment to the United States Constitution, which was not ratified until 1913.

The significance of this historical data is two-fold. The deduction feature of the law was an early recognition by Congress that relief under U. S. tax statutes should be granted to corporations for taxes they were required to pay in foreign countries. The second pertinent observation respecting this historical data is that here in our own tax law is a classic example of a tax "in lieu of" an income tax within the literal meaning of that phrase. In 1895 Congress had attempted to enact an income tax law, but that law was declared unconstitutional. Having been thwarted in its attempt to pass a valid income tax law Congress passed the special excise tax law of 1909 above re-

ferred to "in place of," "instead of," or "in lieu of" an income tax law.

Upon the ratification of the Sixteenth Amendment to the Constitution the income tax act of October 3, 1913, was enacted. In Section G(b) of that act (38 Stat. at L. 173, Chapter 16) a deduction was allowed in computing the net income of a corporation for all sums paid by it within the year for taxes imposed under the authority of the United States or any state or territory thereof, or by the government of any foreign country. Similar provisions were contained in the income tax acts of September 8, 1916, §5(a), §6 (a), and §12(a) (39 Stat. at L. 759, 769, Chapter 463), and in the income tax act amendment of October 3, 1917, §1201(1), §1207(1) (40 Stat. at L. 330, 335, Chapter 63). The special excise tax of August 5, 1909, was not reenacted or carried forward into the income tax act of October 3, 1913. It was repealed by paragraph S, Section IV, Chap. 16 of the act of October 3, 1913 (38 Stat. at L. 201).

In our earliest income tax laws Congress intended to give relief to domestic taxpayers operating in foreign countries by permitting them a deduction under the U. S. income tax law for taxes paid to a foreign government. The fact that the special 1% excise tax imposed under the provisions of the law of 1909 was not carried forward or re-enacted at the time the income tax act of 1913 was passed, indicates conclusively that it is a classic example in our own law of a tax "in lieu of" an income tax.

In the revenue act of 1918 there was a provision for *a credit* against income taxes levied in the United

States for taxes paid to any foreign country upon income derived from sources therein (Sections 222(a), 238(a), 40 Stat. at L. 1073, 1080, Chapter 18). With respect to Congress' change in policy in allowing a credit instead of a deduction the Supreme Court of the United States said:

> "The distinction made with respect to * * * deduction from gross income and credits against taxes simply reflects the economic policy adopted in making allowances for taxes paid within the borders of the continental United States and the organized territories. In relation to income taxes paid outside these borders, the provision as to credit was enacted to give greater, and not less, relief."
>
> *Burnet v. Chicago Portrait Co.* (1932) 285 U.S. 1, 15, 76 L. ed. 587, 594, 10 A.F.T.R. 800.

With respect to the allowance of such credits as distinguished from deductions from gross income in computing net income, the Committee on Ways and Means of the House of Representatives in its report on the revenue bill of 1918 (H.R. Rep. No. 767, 65 Cong. Second Session, page 11) said:

> "Under existing law a citizen of the United States can only deduct income, war or excess-profits taxes paid to a foreign country from gross income in computing net income. With the corresponding high rates imposed by certain foreign countries the taxes levied in such countries in addition to the taxes levied in the United States upon citizens of the United States, placed a very severe burden upon such citizens. The bill provides that a credit against the income tax im-

> posed in the United States be allowed a citizen of the United States, subject to income and war or excess-profits taxes in a foreign country of an amount equal to the tax paid in such country upon income that is received from sources within such country. * * *"

Furthermore, in the report of the Committee on Ways and Means of the House of Representatives in relation to the revenue bill of 1921 (H.R. Rep. No. 350, 67th Cong. First Session, page 8) the following statement was made with respect to American concerns doing business in foreign countries:

> "Under existing law an American citizen or domestic corporation is taxed upon his or its entire income even though all of it is derived from business transacted without the United States. This results in double taxation, places American business concerns at a serious disadvantage in the competitive struggle for foreign trade, and even encourages American corporations doing business in foreign countries to surrender their charters and incorporate under the laws of foreign countries."

While this statement was made to introduce a remedial proposal which was not adopted it discloses the purpose of Congress in liberalizing the foreign tax provisions of U. S. Revenue measures up to that time, and further indicates a trend to broaden and liberalize the basis for allowing foreign tax credit relief to domestic corporations.

A similar foreign tax credit provision was carried over into the revenue act of 1921. Section 222 (a) (42 Stat. at L., 227, 258, 259 Chapter 136). The foreign tax credit provision of the revenue act of 1921

with certain minor changes has been incorporated in each revenue act thereafter up to and including the Internal Revenue Code as amended in 1942.

The obvious and consistent purpose of Congress in incorporating a foreign tax credit provision in our tax law has been to mitigate the evil of double taxation. The same controlling purpose is manifest in the foreign tax credit provision of the 1918 revenue act down to the present. The changes made by Congress in the foreign tax credit provisions of the various acts reveals an unmistakable trend towards a liberalization of the foreign tax credit provisions of our tax acts. By amending and liberalizing the foreign tax credit provisions Congress has sought to make those provisions carry out their purpose more effectively. Obviously the intent of Congress in adding subsection (h) to Section 131 I.R.C. was to broaden the basis for allowing foreign tax credits. Congress intended to have that particular section of the code carry out its purpose (of avoiding double taxation) more effectively, so that under the circumstances of this case appellant's Canadian income would not be subject to double taxation because a foreign tax credit could be allowed under that section as amended.

(b)

The historical background of Section 131 I.R.C. indicates Congress intended to permit a foreign tax credit under the circumstances of this case.

Prior to the amendment of Section 131 I.R.C. in 1942 the Commissioner and the courts on many occasions had construed its terms (See Appendices XX, XXI, XXIII and XIV). These rulings and decisions will be discussed in subsequent parts, so at present a general observation respecting them will suffice. The Commissioner's rulings and the courts' decisions referred to apply the following test:

Was the foreign tax which was claimed as a foreign tax credit a "net income tax upon profits" within the meaning of those terms as employed in the U. S. tax law?

Only if, upon the basis of a very strict examination of the facts, this question could be answered in the affirmative was the foreign tax credit allowed.

An interesting case in point which is relied upon by the Commissioner is the decision of the United States District Court in the case of *St. Paul Fire & Marine Insurance Co. v. Reynolds* (March 9, 1942) 44 F. Supp. 863, 29 A.F.T.R. 592, which will be analyzed more completely in a succeeding part. In that case, applying the traditional test, the court held that the Canadian Special War Revenue tax was an excise tax, and for that reason the taxpayer could not be allowed a foreign tax credit under Section 131 (a) (1) I.R.C. prior to the addition of subsection (h) to Section 131 I.R.C. in 1942.

Considering that decision in its proper historical setting it supports appellant's contention that Congress intended a foreign tax credit to be allowed under the circumstances of this case.

The decision of the District Court in that case was rendered on March 9, 1942. Slightly less than seven months thereafter the Senate Finance Committee, having been deliberating on the amendment of Section 131 I.R.C., issued its report dated October 2, 1942, in which it submitted an amendment to Section 131 I.R.C. That proposed amendment became subsection (h) of Section 131 of the 1942 Internal Revenue Code. Referring to the reason for the addition of subsection (h) to Section 131 I.R.C., the Committee on Finance of the U. S. Senate stated:

> "* * * in the interpretation of the term 'income tax' the Commissioner, the Board and the court have consistently adhered to a concept of income tax rather closely related to our own, and if such foreign tax was not imposed upon a basis corresponding approximately to net income it was not recognized as a basis for such credit. Thus, if a foreign country imposing income taxation authorized for reasons growing out of administrative difficulties of determining net income or taxable basis within that country, a United States domestic corporation doing business in such country to pay a tax in lieu of such income tax, but measured by gross income, gross sales for a number of units produced within the country, such tax has not heretofore been recognized as a basis of credit.
>
> "Your Committee has deemed it desirable to extend the scope of this section. Accordingly,

> subsection (f) of Section 160 provides that the term 'income, war tax and excess profits tax' shall for the purposes of Sections 121 and 23c-1 include a tax paid by a domestic taxpayer in lieu of a tax upon income, war profits and excess profits taxes which would otherwise be imposed upon such taxpayer by any foreign country or by any possession of the United States." (Tr. 39, 60, 61)

It was the expressed intent of Congress to change the law upon which the United States District Court based its decision in the case of *St. Paul Fire & Marine Insurance Co. v. Reynolds, supra.* Clearly, Congress felt that the test employed by the court in that case and the test employed by the Commissioner and the courts in prior cases construing Section 131 was too circumscribed. The expressed intent of Congress in adding subsection (h) to Section 131 was "to extend the scope of this section."

It must be presumed that Congress, in amending Section 131 I.R.C., acted with full knowledge, not only of the terms of the existing statute on the subject, but also with full knowledge of the decisional law interpreting that section, including particularly the most recent construction of the statute by a Federal court prior to the amendment of that section; namely, the case of *St. Paul Fire & Marine Insurance Co. v. Reynolds, supra.*

> *Johnson v. U. S.* (1911) 225 U.S. 405, 416, 32 S. Ct. 748, 56 L. ed. 1142;
>
> *Shamrock Oil & Gas Corporation v. Sheets* (1940) 313 U.S. 100, 106, 85 L. ed. 1215, 1218, 61 S. Ct. 739;

Barnidge v. U. S. (8th C.C.A., 1939) 101 F.(2d) 295, 297;

U. S. v. Stroop (6th C.C.A., 1940) 109 F. (2d) 891, 893, 24 A.F.T.R. 422.

It is well established that change in a later income tax law from the phraseology of an earlier statute which has been given a settled construction by the Treasury Department is indicative of a legislative intention to make a change in the law.

Brewster v. Gage (1929) 280 U.S. 327, 337, 74 L. ed. 457, 463, 50 S. Ct. 115, 8 A.F. T.R. 10263.

It is likewise well settled that where a provision in a statute such as the one involved in this case is intended to be remedial, it must be construed liberally in the taxpayer's favor and must be allowed to prevail in case of conflict with pre-existing rules.

Western Union Telegraph Co. v. Eyser (1873) 19 Wall. (U.S.) 419, 22 L. ed. 43, 44;

Bonwit Teller & Co. v. U.S. (1930) 283 U.S. 258, 263, 75 L. ed. 1018, 1021, 51 S. Ct. 395, 9 A.F.T.R. 1421;

Helvering v. Bliss (1934) 293 U.S. 144, 151, 79 L. ed. 246, 251, 55 S. Ct. 17, 95 A.L.R. 207, 14 A.F.T.R. 668.

Congress must be presumed to have had the District Court's decision in the case of *St. Paul Fire & Marine Insurance Co. v. Reynolds* in mind when, as a remedial measure, it enacted the amendment adding subsection (h) to Section 131. It must be presumed

that Congress had in mind the Canadian Special War Revenue tax which was considered in that case as not eligible to foreign tax credit, when in the report by its Senate Committee on Finance it indicated that a foreign tax credit should be allowed for "a tax in lieu of such income tax but measured by gross income, gross sales, or a number of units produced within the country * * *." The tax for which appellant claims a foreign tax credit is such a tax. That Congress intended to permit a foreign tax credit under the circumstances of this case seems clear. Any doubts regarding the interpretation or application of subsection (h) to this case must be resolved in appellant's favor.

(c)

The historical background of the Internal Revenue Code as applied to mutual insurance companies such as appellant indicates Congress intended to permit a foreign tax credit under the circumstances of this case.

It is evident from an examination of the historical development of the U. S. taxation policies that mutual insurance companies have been traditionally exempt from income taxes under Section 101(11), or a corresponding section of the Internal Revenue Codes prior to the 1942 amendment.

There are numerous sound and logical reasons for such exemption. Mutual insurance companies are nonprofit organizations of the same general type that are customarily exempt from income taxation. In their operation, their system of transacting business is such that they do not develop a "net income" or "a profit" similar to that of business organizations that are sub-

ject to income taxation. Because such companies are fundamentally cooperative enterprises the purpose of which is to furnish insurance protection to members at cost, their purpose places them in a category different from that of the ordinary business enterprise which is subject to tax upon its net income.

The formulation of a satisfactory and equitable basis for taxing of mutual insurance companies has in the past proven administratively difficult. Such difficulty as previously indicated was appreciated by the Senate Committee on Finance, which was largely responsible for the preparation of the 1942 amendment which made appellant subject to taxation in the U. S. under Section 207 I.R.C., and which also added subsection (h) to Section 131 I.R.C. When the 1942 amendment to the Internal Revenue Code was under consideration the Senate Finance Committee in its report had this to say regarding the taxation of mutual insurance companies:

> "Under the House Bill mutual insurance companies, other than life, were to be taxed on the basis of their underwriting and investment income. The objective was a taxing system substantially the same as that which has been applied to stock insurance companies other than life since 1921. * * *
>
> "Your committee carefully considered the House Bill plan and various modifications of it in an attempt to define and tax underwriting income (*of mutual insurance companies*) in an equitable manner. No adequate method to accomplish that result was developed. * * *" (Italicized portion inserted) (Appendix No. XV)

Congress had its own experience in mind when in adding subsection (h) to Section 131 it indicated its intent to allow a foreign tax credit "* * * if a foreign country imposing income taxation authorized by reasons growing out of administrative difficulties of determining net income or taxable basis within that country, a United States domestic corporation doing business in such country to pay a tax in lieu of such income tax but measured by gross income * * *" (Tr. 39, 60).

Although mutual insurance companies such as the appellant have been traditionally exempt from the payment of income taxes under U. S. Internal Revenue Codes prior to 1942, it does not follow that they have always been exempt from taxation. At the time of the first world war mutual insurance companies such as appellant were subject to a tax of 1% on their policy premiums (Section 504, Revenue Act of 1917, Appendix No. XV, Revenue Act of 1918, Appendix No. XVI). These revenue measures were re-enacted in substantially the same form each year through 1921. For that period such companies were not required to pay income taxes (Appendices Nos. VIII and XVII).

This historical data demonstrates another classic example of a tax in our own Internal Revenue Code that was in effect a tax "in lieu of" or "in place of" an income tax, insofar as it was applied to mutual insurance companies such as appellant.

From 1921 to 1942 various minor changes were made in the exemption of mutual insurance companies

under the U. S. Internal Revenue Code, until in the 1942 amendment the following change was made by Section 165(e) of the 1942 act.

Prior to the 1942 amendment Section 101(11) read as follows:

> "(11) Farmers or other mutual hail, cyclone, casualty or fire insurance companies or associations (including inter-insurers and reciprocal underwriters) the income of which is used or held for the purpose of paying losses or expenses." (Appendix No. XVII)

The 1942 amendment changed said section to read as follows:

> "(11) Mutual insurance companies or associations other than life or marine (including inter-insurers and reciprocal underwriters) if the gross amount received during the taxable year from interest, dividends, rents and premiums (including deposits and assessments), does not exceed $75,000.00." (Appendix No. XVIII)

This change in our own tax law in 1942 made the larger mutual insurance companies such as appellant subject to income taxation. The exact basis of their taxation will be considered in detail in a later part. For the present it will be sufficient to observe that in 1942 mutual insurance companies such as appellant were made subject to tax under Section 207 I.R.C. at the rate of 1% on their "gross amount of income."

At this same time in Canada mutual insurance companies such as appellant were paying a tax to the Dominion of Canada in the amount of 3% on "net premiums" which is, in effect, a gross income tax.

What was the intent of Congress in adding subsection (h) to Section 131 I.R.C. in 1942? In said year Congress imposed upon mutual insurance companies such as the appellant a tax under section 207 I.R.C. on a "gross income" basis. Such tax itself was "in lieu of" or "in place of" a "net income tax" of the traditional kind. At the time of levying such tax on such basis on mutual insurance companies such as appellant Congress liberalized the provisions of Section 131 by adding thereto subsection (h) to permit the granting of credit for taxes paid to foreign countries on a similar basis. The tax for which appellant claims a credit is a tax imposed on a similar basis as will be pointed out in the next section. Manifestly, Congress intended that appellant should be allowed a foreign tax credit under these circumstances.

(d)

The similarity between the basis of appellant's tax under the United States and Canadian laws indicates Congress intended to permit a foreign tax credit under the circumstances of this case.

Although prior to 1942 appellant was able to qualify for exemption under U. S. tax laws, in that year the U. S. Internal Revenue Code was amended, as previously observed, so as to impose upon appellant an income tax under the provisions of Section 207 I.R.C. Significantly, such section did not impose on appellant the traditional type of income tax. Prior to the 1942 amendment the term "income tax" as employed in U. S. tax law referred only to a "net income tax" imposed upon "profits."

Under the provisions of Section 207 I.R.C., mutual insurance companies such as appellant may be subjected to a tax upon the basis of their "*net investment income,*" or they may be subjected to a tax on the basis of their *gross amount of income.* Whichever basis produces the larger tax is the basis that must be used. During 1942 and 1943 appellant actually paid its tax under the provisions of Section 207 on the basis of its gross amount of income. The gross amount of income as defined in that section is composed of net premiums and gross investment income. It is clearly not an "income tax," as that term was used prior to the enactment of the 1942 amendment to Section 207 I.R.C. In fact and in operation it is actually a tax "in lieu of a tax upon income" within the literal meaning of that phrase, if the traditional definition of income tax is employed. Admittedly, the U. S. statute does not specifically refer to such tax as a tax in lieu of a tax upon income. There are no administrative rulings and no court decisions that specifically hold that the alternate tax under Section 207 based upon the gross amount of income of a mutual fire insurance company is a tax in lieu of a tax upon income. Obviously, however, such tax was intended to be a tax in lieu of a tax upon income of such mutual insurance companies according to the standards employed in our own tax law prior to 1942.

The Canadian Special War Revenue Tax for the years 1942 and 1943 provides a perfect analogy. Admittedly, the Canadian law does not specifically state that it is a tax in lieu of a tax upon income. Nor are there any court decisions or administrative rulings

so providing. But in fact and in operation it is as much of a tax in lieu of an income tax of the traditional kind as the tax imposed on appellant under Section 207 I.R.C.

The tax paid by appellant for those years in the United States was virtually a "premium tax" at the rate of 1%. Gross income under Section 207 I.R.C. is composed of net premiums and gross investment income. The relationship between the investment income and net premium income of a general writing insurance company such as appellant may be illustrated by appellant's returns for the years 1942 and 1943 (See Appendix No. XI). During those years appellant's "net premiums" constituted approximately 97% of its *gross amount of income* which, under Section 207 I.R.C., was the basis of its income tax in the United States. Thus, where the taxpayer pays its tax on the basis of the gross amount of income under Section 207 the "net premiums" of the taxpayer constitute by far the largest part of its taxable income. The investment income is an almost negligible factor in the production of taxes payable under the gross amount of income provision of Section 207 I.R.C. Because appellant's taxes for those years was based largely upon its net premiums, for practical purposes it might be said that during those years appellant paid a "net premium tax" in the United States. This included the same "net premiums" of appellant that were taxed as such by the Dominion of Canada. In fact, during 1942 and 1943 appellant's "net premiums" on its Canadian operations in the amounts of $509,072.00 and $540,084.67, respectively (as con-

verted from Canadian to U. S. dollars at 90.909%) were, for practical purposes, taxed as such in both Canada and the United States. In the United States the tax was called a "gross amount of income tax." In Canada it was called the Special War Revenue "net premium tax." Appellant contends that what the respective taxes were called is unimportant. Their effect is important. The appellee cannot deny that their effect was to subject appellant's "net premiums" on its Canadian operations to *double taxation.* The appellee cannot deny that the consistent intent of Congress in enacting and amending Section 131 I.R.C. has been to mitigate, as far as possible, the evils of double taxation—to thereby encourage domestic corporations to operate in foreign countries with assurance that their income there will not be taxed again here. The appellee cannot deny that subsection (h), when added to Section 131 I.R.C. by Congress, was added with the express intention of liberalizing the provisions of that section so that it could carry out more effectively that broad general purpose of avoiding double taxation. Indeed the similarity between the basis of appellant's tax under the U. S. and Canadian laws indicates Congress expressly intended to permit a foreign tax credit under the circumstances of this case.

IV.

Construing the Special War Revenue Act, as Applied to Mutual Insurance Companies, Such as Appellant, According to the Intent of Parliament Indicates Appellant is Entitled to the Foreign Tax Credit Claimed.

The Commissioner has denied appellant's foreign tax credit claim because there is no court decision, administrative ruling, or declaration in the Canadian laws that indicates in express terms that the Canadian Special War Revenue Act was intended by Parliament to be a tax in lieu of a tax upon the income of mutual insurance companies such as appellant. Had there been such express provisions this action would never have arisen. Appellant contends that the provisions of Section 131 I.R.C. do not require that a foreign tax, to be allowed as a credit, must be imposed under a law which states expressly that it is a tax "in lieu of" a tax upon income.

While appellant contends that the standard adopted by the Commissioner for determining the allowability of foreign tax credits is too strict, appellee must concede that the intent of the foreign legislative body, in this case Parliament, has some probative value. In the proof of a claim under Section 131(h) I.R.C. the appellee would apparently agree that if the Canadian Parliament intended the Special War Revenue Act as amended in 1942, to serve as a tax "in lieu of" an income tax for mutual insurance companies such as appellant, then the taxes paid by appellant to Canada under the provisions of that law would be taxes for which a credit could be allowed under the provisions of Section 131(h) I.R.C. For that reason

appellant will discuss the facts that tend to establish the intent of Parliament.

(a)

The early historical background of the Canadian Special War Revenue Act and the Income War Tax Act indicates the Canadian Parliament intended the Special War Revenue Act to serve, during the years of 1942 and 1943, as a tax "in lieu of" an income tax for mutual insurance companies such as appellant.

Very much like the special excise tax of 1909 in our own law which was enacted prior to any general income tax act, the Canadian Special War Revenue Act of 1915 was enacted prior to any general income tax act in Canada. As previously observed, the U. S. special excise tax of 1909 was a tax of 1% on net income in excess of $5,000.00. The Special War Revenue Act of 1915 was a tax of 1% on net premiums. As observed, according to the literal meaning of the words the, U. S. special excise tax of 1909 was a tax "in lieu of" an income tax, because it was enacted some four years prior to the passage of a general income tax law in the United States, to serve as a revenue measure until an income tax law could be enacted. In the same sense, according to the literal meaning of the words, the Special War Revenue tax, when first enacted, was a tax "in lieu of" an income tax which was not imposed in Canada until two years later.

It was in 1917 that the Canadian Income War Tax Act was passed, imposing for the first time a general income tax in Canada. The joint stock type of insur-

ance companies operating for profit were subject to taxation under the Canadian Income War Tax Act of 1917, but the mutual type of insurance organizations, such as appellant, were exempt from taxation under the Canadian Income War Tax Act of 1917 (Tr. 28, 29, 52, 53). Insurance companies organized and operating for profit on the joint stock company plan, which were subject to the income tax law, were permitted to deduct, from their income taxes otherwise payable, the amount of tax which they had paid under the Special War Revenue Act of 1915. Section 7 of Part III of the Canadian Income War Tax Act of 1917, read as follows:

> "A taxpayer shall be entitled to deduct from the tax that would otherwise be payable by him under this act the amount paid for corresponding periods under the provisions of Parts II and III of the Special War Revenue Act of 1915."

The significance of this historical data is two-fold. First, it indicates that prior to the enactment of the Canadian Income War Tax Act of 1917 the Canadian Special War Revenue tax of 1915, according to the literal meaning of the phrase, was a "tax in lieu of" an income tax for all insurance companies. Secondly, it indicates that, at the time of the passage of the Canadian Income War Tax Act of 1917, the Special War Revenue tax as imposed upon joint stock companies paying an income tax, was no longer a tax "in lieu of" an income tax. With respect to mutual insurance companies such as appellant, which were exempt from income taxation, the Special War Revenue tax continued to be a tax "in lieu of" an income tax.

As previously observed, during the period 1917 to 1921, in our own tax laws mutual insurance companies such as appellant were subject to a tax of 1% on their premiums, but were not during that period required to pay the general income tax imposed in the United States. As observed, according to the literal meaning of the term, that tax was a tax "in lieu of" an income tax with respect to mutual insurance companies. During that same period in Canada mutual insurance companies such as appellant were subject to a tax of 1% on their net premiums, but were not during such period subject to Canada's general income tax law. According to the literal meaning of the phrase, such Canadian tax was likewise a tax "in lieu of" an income tax with respect to mutual insurance companies.

In our own tax laws the 1% federal premium tax was not imposed after 1921. From 1921 to 1942 mutual insurance companies such as appellant, did not pay federal income taxes in the United States. In Canada the 1% tax on premiums continued to be imposed up to 1942 on all insurance companies, and during said period for mutual insurance companies such as appellant, exempt by law from the Canadian Income Tax, it continued to be, as to such companies, a tax "in lieu of an income tax otherwise generally imposed."

(b)

The historical background of the 1942 amendment to The Special War Revenue Act indicates the Canadian Parliament intended it to serve during the years 1942 and 1943 as a tax "in lieu of" an income tax for mutual insurance companies such as appellant.

From 1917 to 1942 mutual insurance companies such as appellant operating in Canada were exempt from the general income tax law of Canada (Tr. 28, 29, 54, 55). For said period the only equivalent Dominion tax imposed upon such companies was the Special War Revenue tax at the rate of 1% (Tr. 32, 33, 53).

In 1942, as in 1915, Canada was engaged in another war and the need for additional revenue was acute. An increase in all taxes was necessary. Accordingly, at that time the Special War Revenue Act was amended. As applied to insurance companies organized on the joint stock company basis—that is, companies operating for profit (which were subject to the general Canadian income tax and excess profits tax)—the rate of said tax was increased by the 1942 amendment from 1% to 2% (Tr. 32, 33, 54). As applied to insurance companies, such as appellant, organized on the mutual basis—that is, companies not operating for profit (which were not subject to the general Canadian income tax act or the excess profits tax)—the rate of said tax was increased by the 1942 amendment from 1% to 3% (Tr. 33, 34, 54).

At the time of the amendment of the Special War Revenue Act in 1942 no change was made in the provision of the Canadian Income War Tax Act which

exempt mutual insurance companies such as appellant from taxation thereunder (Tr. 28, 37, 54, 55).

In the Parliamentary debates at the time of the adoption of the 1942 amendment to the Special War Revenue Act, Honorable J. L. Ilsley, Minister of Finance, in justification of the apparent discrimination in rates of the proposed amendment pointed out that the higher rates imposed by the proposed amendment were imposed because of advantages in income taxation enjoyed by organizations paying the higher rates under the Special War Revenue Act. A member of Parliament, Mr. Diefenbaker, asked the following question: "Why it it that, for instance, Lloyds are required to pay 3 per cent tax and other companies in the Dominion of Canada 2 per cent, and that every mutual company shall pay to the Minister a tax of 4%? What is the reason for the apparent difference in rates?" While the following statements of the Minister of Finance in response to that specific question did not specifically refer to mutuals, the same controlling purpose behind the rate differential is evident in the case of mutual insurance companies. Obviously, the Minister of Finance intended his remarks to apply to mutuals as well as Lloyds. With respect to the imposition of taxes on them the Hon. Mr. Ilsley (Minister of Finance) stated as follows:

> "* * * Therefore you have the competitors of Lloyds paying income tax on a less advantageous basis than Lloyds. We contend that it is fair that Lloyds should pay premium tax on a less advantageous basis than others.
>
> * * * * * * * * * *

> "No, my whole argument is that income tax is imposed on Lloyds on a more favorable basis than on their competitors in Canada, and conversely the premium tax is higher on Lloyds than on their competitors."

See Dominion of Canada, official Report of Debates, House of Commons, Third Session, Ninth Parliament, 6 George VI, Volume V, 1942, July 24, 1942, pages 4643, 4644.

These remarks of the Canadian Minister of Finance at the time of the adoption of the 1942 amendment to the Canadian Special War Revenue Act are significant for two reasons. They indicate that in 1942 Lloyds and mutuals, such as appellant, which were subject to a 3% tax under the Canadian Special War Revenue Act rather than a tax of 2% because they enjoyed an advantage under Canada's general income tax law that was not enjoyed, and could not be enjoyed by the stock insurance companies. Secondly, it indicates that mutual insurance companies such as appellant were subject to a tax at the rate of 3% under the Canadian Special War Revenue Act as amended in 1942, because the advantage they enjoyed was complete exemption from the payment of taxes under the Canadian Income War Tax Act. This differential in rate is thus positive evidence of the fact that the Canadian Parliament intended the Special War Revenue Act to serve, during the years 1942 and 1943, as a tax "in lieu of" an income tax for mutual insurance companies such as appellant.

(c)

The background of the 1946 amendment to the Special War Revenue Act indicates the Canadian Parliament intended it to serve during the years 1942 and 1943 as a tax "in lieu of" an income tax for mutual insurance companies such as appellant.

Prior to the 1946 amendment to the Canadian tax laws mutual insurance companies such as appellant were exempt from Canada's general income tax law under Section 4 (g) of the Canadian Income War Tax Act (Tr. 28, 29, 37, 54, 55). By virtue of such exemption appellant was also exempt from taxation under the Canadian Excess Profits Tax Act of 1940. This exemption appeared in the Canadian Income War Tax Acts from its original enactment in 1917 until 1946 (Tr. 35, 36, 54, 55). By the terms of the 1946 amendment to the Canadian Income War Tax Act this exemption was so restricted that beginning with January 1, 1947, general writing mutual fire and casualty insurance companies, including the appellant, were made subject to the general income tax law of Canada (Tr. 35, 36, 54, 55).

After January 1, 1947, corporations operating on the mutual principle (other than insurance corporations) continued to be exempt from the general income tax law, and mutual companies which derived all of their premiums from insurance on churches, schools or other religious, educational or charitable institutions, continued to be exempt, but general writing mutual fire and casualty insurance companies such as appellant on that date became subject to the general income tax law of Canada (Tr. 35, 36, 54).

In 1946 when the exemption from income and excess profits taxes was withdrawn from mutual fire and casualty companies (except those insuring only churches, educational and charitable institutions) Parliament amended the Special War Revenue Act at the same session reducing the premium tax rate on mutual companies from 3% and 4% down to 2% (Tr. 38, 55). The premium tax rate under the Special War Revenue Act since 1946 has been 2% for general writing mutual fire and casualty insurance companies such as appellant, as well as for stock insurance companies (Tr. 38, 54, 55). This was accomplished by amending Section 14 of the Special War Revenue Act, so that Section 14 (1) was made applicable to general writing mutual fire and casualty companies such as appellant (Tr. 37, 38, 55). At the same time Section 14 (2) was amended to apply to Lloyds and reciprocal exchanges only and provided for the levy of a tax at the rate of 3% on such insurance organizations. Section 14 (3) was repealed by the 1946 amendment.

Parliament made the changes in the Special War Revenue Act in 1946 in accordance with the budget resolution presented to Parliament by the Minister of Finance speaking for the administration. In presenting the budget resolution to the House of Commons the Honorable Douglas Abbott (Acting Minister of Finance) in explaining the proposed reduction in rate from 3% to 2% as applied to general writing mutual insurance companies stated as follows:

> "In view of the fact that these mutual insurance companies will no longer be completely exempt from tax, a reduction is being proposed in

> the premium tax under the Special War Revenue Act applying to these companies." (Appendix No. XXV)

As observed, the 1946 amendment preserved a differential in rate in the taxes it imposed. While stock and general writing mutual insurance companies were taxed at the rate of 2% Lloyds and reciprocal exchanges were taxed at the rate of 3%. In presenting the budget resolution the Honorable Mr. Abbott in explanation of this rate differential stated as follows:

> "These two classes, it is believed, will not be subject to corporation income tax in Canada, and because of this fact the premium tax in their case will be 3% in place of the general 2%." (Appendix No. XXV)

These pertinent comments, together with the comments of Mr. Abbott in the House of Commons and the Honorable Messrs. Hayden and Euler in the Senate (set forth in Appendix No. XXV) indicate: (1) that up to 1946 the Special War Revenue Tax was the "principal tax" imposed by the Dominion of Canada upon mutual insurance companies such as appellant; (2) that prior to 1946 the income of mutual insurance companies was "reached through the medium of a tax on premiums"; (3) that "the tax on premiums was practically the same in amount as an income tax on them would have been"; (4) that they were not subject to the corporation income tax in Canada, "and because of this fact" the premium tax in the case of such mutual companies was 3% in place of the general 2%.

Thus, with respect to mutual insurance companies

such as appellant the Special War Revenue Act was in fact, and was intended by Parliament to be, a tax "in place of" or "in lieu of" an income tax on such companies in 1942 and 1943.

V.

The Applicable Rulings by the Commissioner of Internal Revenue Indicate That the Appellant Is Entitled to the Foreign Tax Credit Claimed

(a)

The Commissioner's rulings prior to 1942 indicate appellant is entitled to the foreign tax credit claimed.

An examination of the Commissioner's rulings construing the foreign tax credit provisions of the U. S. Revenue Acts from 1917 to date indicates that these rulings have been based upon the same test to determinte whether or not the foreign tax credit should be allowed. No substantial change has taken place since the addition of subsection (h) to Section 131 I.R.C. in 1942.

An analysis of the pertinent rulings construing the foreign tax credit provisions of the Revenue Acts from 1917 to 1942 indicates that the foreign tax credit has been allowed whenever the foreign tax under consideration was based upon profit or "income" as that term was understood and employed in United States tax laws. They indicate that the concept of "income" as the term was understood in our tax laws up to 1942 was a gain derived from the employment of labor or capital or both. I.T. 2620 XI-1, C.B. 44 (See Appendix No. XX for additional rulings).

An analysis of the Commissioner's rulings between

1917 and 1942 in which the foreign tax credit was denied leads to two general conclusions. First, that a foreign tax that did not obviously qualify as a tax on "income" within the concept of that term as it was used and recognized in the United States income tax law was not allowed as a credit. I.T. 1444, I-2, C.B. 168, I.T. 2909, XIV-2, C.B. 136 (See Appendix No. XXI for additional rulings).

Secondly, it leads to the conclusion that there has been an observable tendency on the part of the Commissioner to construe the foreign tax credit provisions of the various revenue acts more strictly, rather than more liberally. Compare I.T. 2070, III-2, C.B. 250 and I.T. 2909, XIV-2, C.B. 136; *United States Fidelity & Guaranty Co. v. Commissioner* (1926) 5 B.T.A. 23 and I.T. 3138, 1937-2, C.B. 230 (See Appendices Nos. XX, XXI).

Of the foregoing rulings the one that is particularly pertinent in the instant case is I.T. 3138, 1937-2, C.B. 230. In construing the foreign tax credit provisions of the Revenue Acts of 1932 and 1934 the Commissioner ruled that the 1% premium tax imposed by the Canadian Special War Revenue Act could not be allowed as a foreign tax credit. Considering this particular decision in its proper setting supports appellant's contention that it is entitled to the foreign tax credits claimed.

Prior to this ruling taxpayers had been permitted to claim the Canadian Special War Revenue Tax as a foreign tax credit. See *United States Fidelity and Guaranty Co. v. Commissioner* (1926) 5 B.T.A. 23 and the discussion of Internal Revenue Department

policy in *St. Paul Fire & Marine Insurance Co. v. Reynolds* (1942) 44 F. Supp. 863, 865, 29 A.F.T.R. 592. This ruling therefore, represented a change in the Commissioner's policy with respect to this particular tax, and a change toward a more strict construction of the foreign tax credit provisions of our own Revenue Acts.

The reasoning that led to the conclusion set forth in this ruling should be considered. First, the familiar test was applied to determine whether or not the tax was a tax on "income" within the concept of that term as used in the U. S. tax law. In applying the test to the facts the Commissioner observed that the tax was imposed under the provisions of the Special War Revenue Act which in name, at least, was separate and distinct from the Canadian Income Tax Act. The Commissioner further observed that the tax was imposed on the net premiums of the taxpayer without regard to whether or not a gain or net profit was realized therefrom. That decision was based to some extent upon the fact that the deductions permitted under the Special War Revenue Act were completely unrelated to the deductions permitted under U. S. Income Tax Laws. On that basis and because premium taxes were generally regarded as excise or privilege taxes the Commissioner concluded that the Special War Revenue tax was not a tax on income as the term was understood and used in our tax laws up to that time and for that reason could not be allowed as a foreign tax credit.

That Commissioner's ruling is of interest not only because of the line of reasoning upon which it was

based, but also because of the fact that it was affirmed by the Board of Tax Appeals in the case of *Continental Insurance Company v. Commissioner* (Sept. 9, 1939) 40 B.T.A. 540, and by the United States District Court in the case of *St. Paul Fire & Marine Insurance Company v. Reynolds* (March 9, 1942) 44 F. Supp. 863, 29 A.F.T.R. 592, which as previously indicated was decided just a little more than six months before the adoption of the 1942 amendment adding subsection (h) to Section 131 I.R.C.

An analysis of all of the Commissioner's rulings leads to the conclusion that prior to the addition of subsection (h) to Section 131 I.R.C. a foreign tax would not be allowed as a foreign tax credit if: (1) it was a tax based upon gross receipts, gross sales, or gross revenue; (2) it was a tax imposed without regard to whether or not a gain or profit was realized; (3) it was imposed under a statute which was not a part of the general income tax act of the foreign country imposing the tax. This represents in general terms the effect of the Internal Revenue Department rulings immediately prior to the addition of subsection (h) to Section 131 I.R.C.

As previously indicated herein the 1942 amendments to the Internal Revenue Code made at least two major changes in the previous Revenue Act. First, the 1942 amendment to Section 207 made provision for imposing on mutual fire insurance companies, such as the appellant, a tax without regard to whether or not a gain or profit was realized, on the basis of gross amount of income (net premiums plus gross investment income). Secondly, the 1942

amendment extended the foreign tax credit provisions of Section 131 by the addition of subsection (h).

As previously observed in Part III(b) *supra*, at the time of the addition of subsection (h) to Section 131 I.R.C. in 1942, and in regard to the broadening of the foreign tax credit provisions of that section, the Committe on Finance of the Senate stated:

> "* * * In the interpretation of the term 'income tax' the Commissioner, the Board and the Courts have consistently adhered to a concept of income tax rather closely related to our own, and if such foreign tax was not imposed upon a basis corresponding approximately to net income it was not recognized as a basis for such credit. Thus if a foreign country in imposing income taxation authorized * * * a United States domestic corporation doing business in such country to pay a tax in lieu of such income tax but measured for example by gross income, gross sales or a number of units produced within the country, such tax has not heretofore been recognized as a basis for credit. Your Committee has deemed it desirable to extend the scope of this section * * *."

This quotation is repeated here to emphasize the fact that:

(1) Congress was cognizant of the Commissioner's rulings referred to and was familiar with the line of reason upon which they were based; (2) Congress intended to liberalize or "extend the scope" of the foreign tax credit provisions of the Code; (3) Congress specifically intended to change the foreign tax credit test that prior to the 1942 amendment had required that the foreign tax must be imposed upon

substantially a net income basis before it could be allowed as a foreign tax credit; (4) Congress specifically intended that a foreign tax based upon gross income, such as the Special War Revenue tax should not be disallowed as a foreign tax credit for that reason.

(b)

The Commissioner's rulings since 1942 indicate appellant is entitled to the foreign tax credit claimed.

An examination of the Commissioner's rulings since the enactment of the 1942 amendment should indicate why the Commissioner and the Tax Court have wrongfully denied appellant a foreign tax credit to which it is entitled.

An analysis of the pertinent rulings construing the foreign tax credit provisions of the Internal Revenue Code from 1942 to date indicates that the Commissioner is employing, without change, the same test that was employed prior to the amendment of Section 207 I.R.C., and prior to the addition of subsection (h) to Section 131 I.R.C. in 1942. They indicate that the foreign tax credit has been allowed only when the foreign tax was placed upon profit or "income" as that term was understood and employed in United States tax laws prior to 1942. I. T. 3778, 1946-1, C.B. 11 (See also Appendix No. XXII for additional rulings).

Perhaps the Commissioner's ruling in I. T. 3903, 1948-8, C.B. 5, would seem to be an exception to the rule. It is not. There the Commissioner ruled that a 3% Cuban tax on the gross revenues received from

freight and passengers taken aboard in Cuban ports by foreign shipping companies was a tax for which a foreign tax credit would be allowed under Section 131(h) I.R.C. Allowing the credit under the provisions of subsection (h) of Section 131 is the only revolutionary part of the rulings. The Cuban tax under consideration is an additional tax imposed under the same tax statute that was the subject of the Commissioner's ruling in I. T. 2596, X-2, C.B. 184 (See Appendix No. XXI, page A-22) in which, construing the foreign tax credit provisions of the Revenue Act of 1928, the Commissioner ruled that the tax was an excise tax and that it could not be allowed as a foreign tax credit. The earlier ruling was nullified, however, by the Board of Tax Appeals in the case of *Seatrain Lines Inc. v. Commissioner* (1942) 46 B.T.A. 1076. That ruling, therefore, merely represents the Commissioner's confirmation of the decision of the Board of Tax Appeals in the *Seatrain* case, *supra*, and a ruling that the tax in question should be allowed as a foreign tax credit under the provisions of the new subsection (h) of Section 131. In the *Seatrain* case, *supra*, it was held that a similar tax imposed under the same law could be allowed as a credit under the provisions of Section 131(a)(1) of the Revenue Act of 1936 which is carried over into the present revenue act.

Since the addition of subsection (h) to Section 131 I.R.C., in 1942, there has been only one ruling that a foreign tax could not be claimed as a credit under Section 131 as amended. An Ecuador contribution tax of 5% on net profits of employers was disallowed as a

foreign tax credit. I.T. 3768, 1945 C.B. 204. That tax was imposed for the specific purpose of providing numerous benefits for employees under the labor code of Ecuador. The Commissioner's ruling was based upon the conclusion that the tax was not a "tax" as the term is generally understood, but was rather an imposition for the purpose of regulating certain industries or businesses and that it was not for the purpose of raising revenue for the general support of the government.

These are the pertinent rulings that have been published since the addition of subsection (h) to Section 131 I.R.C. in 1942. The Commissioner's ruling in the instant case has not been published, but it is apparent that in this case the Commissioner's ruling follows the pattern of the rulings issued both prior and subsequent to the 1942 amendment.

(c)

Applying the Commissioner's own test indicates appellant is entitled to the foreign tax credit claimed.

The Commissioner has denied appellant's foreign tax credit in this case because in the Commissioner's opinion the Canadian tax in question is not a tax on "income" as that term was understood in the United States tax laws prior to 1942. What the Commissioner's ruling in this case ignores is fundamental. It ignores the admitted fact that the concept of an "income tax" as the term is used in the Internal Revenue Code changed considerably with the enactment of the 1942 amendments to Section 207 and Section 101 (11) (See Appendices Nos. II and XVIII).

It is for that reason that it is appellant's contention that the Commissioner's rulings indicate that appellant is entitled to the foreign tax credits claimed. For the purpose of elucidating appellant's contention let us apply the Commissioner's test to the Canadian tax in question, noting, however, that the concept of an "income tax" as the term is used in the United States Internal Revenue Code has changed fundamentally with the amendment of Section 207 I.R.C. in 1942. What are the facts with respect to the "income tax" imposed by our Code upon mutual fire insurance companies such as the appellant after 1942? As previously pointed out in a preceding part our own "income tax" on mutual fire insurance companies imposed under Section 207 I.R.C. as amended in 1942 indicates:

(1) The alternate tax is based upon *gross amount of income*, which consists very largely of *"net premiums."*

(2) The alternate tax is not a tax imposed upon "profit" or "income" from the employment of capital or labor or both as that term was used and understood in our tax law prior to 1942.

(3) The alternate tax paid by appellant is imposed upon its "net premiums" and "gross investment income" irrespective of whether or not a profit is realized.

As mentioned in a preceding part a drastic change was made in the concept of "income tax" as that term had previously been understood in our tax law. Prior to the 1942 amendment foreign taxes were disallowed as foreign tax credits when found to possess any one of the above characteristics because the tax was not

a tax on income as that term was understood and employed in the U. S. tax law.

What are the characteristics of the Canadian Special War Revenue tax for which the foreign tax credits are claimed? The Canadian taxes possess the same general characteristics as the tax paid by the appellant under the alternate tax provisions of Section 207 I.R.C. as amended in 1942.

Prior to the 1942 amendment the tax could have been disallowed and would have been disallowed as a foreign tax credit if found to possess any one or more of these characteristics. The reason for the disallowance of a similar tax as a foreign tax credit in I. T. 3138, 1937-2, C.B. 230 (Appendix No. XXI) was that the Canadian tax was not a tax on income as that term was understood and employed in the U. S. tax law. The Commissioner's ruling in this case was based upon the same reason. Such reason ignores the facts.

This indicates that a proper application of the Commissioner's own test regarding the granting or denial of foreign tax credits, if interpreted in light of the 1942 amendment, will indicate that appellant should be allowed the foreign tax credit claimed.

Assume that in 1942 Congress did not intend to change the fundamental concept of an "income tax" as that term had been understood and used in our tax laws prior thereto. The conclusion is inescapable that appellant is entitled to the foreign tax credit claimed.

Assume that an "income tax" must still be a tax on profit or on the gain from the employment of capi-

tal or labor or both. Assume that this is the standard by which foreign taxes must be measured. Measured by this standard it is clear that the alternate tax imposed on the appellant by Section 207 I.R.C., as amended in 1942, is *not* an "income tax." If such tax is not an "income tax" it certainly is "a tax paid in lieu of a tax on income" as that phrase is employed in subsection (h) of Section 131 I.R.C., which was also added by amendment in 1942. This is true even though our tax law does not specifically state that it is "a tax in lieu of a tax on income," and in spite of the fact that there are no administrative rulings, or court decisions so holding.

Assume then, that the Canadian Special War Revenue Tax is not an "income tax" as that term is understood and used in the U. S. Internal Revenue Code. The conclusion is inescapable that such tax is "a tax in lieu of a tax on income" as that phrase is employed in subsection (h) of Section 131 I.R.C. The similarity between the U. S. and Canadian taxes has been previously discussed. Both are based largely on "net premiums," both are imposed irrespective of whether a gain or profit is realized; both were imposed as war revenue measures to increase the general revenue of the respective governments to support the war effort; both are imposed when in fact the taxpayer does not pay a tax under the general income tax provisions applicable to other corporations. The fact that both in Canada and the United States there is no specific reference to the tax as "a tax in lieu of a tax on income" either in the law, the administrative rulings or the decisions of the court lends support to

appellant's contention that if the one is an "in lieu of tax" the other must be.

For that reason the Commissioner's own test indicates appellant is entitled to the foreign tax credit claimed. The Commissioner's rulings, as pointed out in this part, support appellant's claim.

VI.

The Applicable Case Law Indicates Appellant Is Entitled to the Foreign Tax Credit Claimed.

(a)

The historical background of the cases dealing with the Canadian Special War Revenue Tax as a permissible foreign tax credit indicates appellant is entitled to the foreign tax credit claimed.

From the decision of the Federal District Court in the case of *St. Paul Fire & Marine Insurance Company v. Reynolds* (1942) 44 F. Supp. 863, 866, 29 A.F.T.R. 592, it appears that from 1918 until 1926, during which period there was no case law on the subject, the Commissioner allowed the Canadian Special War Revenue tax as a credit against taxpayers U. S. income tax. In 1926 in the earliest case law in which the question was raised, the Canadian Special War Revenue tax was conceded to be an income tax within the purview of Section 38 of the Revenue Act of 1918.

U. S. Fidelity & Guaranty Company v. Commissioner (1926) 5 B.T.A. 23.

The fact that for the purposes of that case the Commissioner conceded that the Special War Revenue

Tax of 1% on premiums paid to the Dominion of Canada was an income tax indicates that from 1918 to 1926 the Canadian Special War Revenue Tax was consistently allowed by the Commissioner as a foreign tax credit.

The Commissioner's practice from 1926 to 1937 is obscure, there being no printed regulations dealing specifically with the Canadian Special War Revenue Tax. Presumably, the long recognized practice of allowing it as a foreign tax credit continued up to 1937. That such was the case seems evident. During most of that period appellant was the owner of the Northwest Casualty Company, a stock casualty company, which operated in both Canada and the United States. In the Commissioner's field audit of that company's U. S. income tax return as late as January 20, 1936, D. M. Kirby, Internal Revenue Agent, on behalf of the Commissioner stated, respecting the Canadian Special War Revenue Tax, the following:

> "The taxpayer was subject to the tax on gross revenue levied for 1934, by the Dominion of Canada under the Special War Revenue Act in the amount of * * *.
>
> "This tax has been held to be an income tax (5 B.T.A. 23) and in prior years has been claimed as a credit for income taxes paid to a foreign country * * *."

In 1937 in I.T. 3138, 1937-2, C.B. 230 (Appendix No. XXI), the Commissioner ruled that under Section 131 of the Revenue Acts of 1932 and 1934 the Canadian Special War Revenue Tax of 1% on net premiums could not be allowed as a foreign tax credit.

The question of allowing the Special War Revenue Tax as a foreign tax credit was not again litigated until in 1939 the Board of Tax Appeals case of *Queen Insurance Company of America v. Commissioner* (August 18, 1939), 40 B.T.A. 484. In that case the Board of Tax Appeals held that where the Canadian Income War Tax Act provided that the taxpayer could deduct from the amount of income tax otherwise due the amount of premium taxes paid under the Special War Revenue Act, the taxpayer was entitled to claim the full amount of the income tax (including that portion actually paid as Special War Revenue taxes) as a foreign tax credit under the provisions of Section 131(a)(1) I.R.C. This constituted a holding that the Canadian Special War Revenue Tax could be indirectly allowed as a foreign tax credit under Section 131(a)(1) I.R.C. That case was soon followed by the case of *Continental Insurance Company v. Commissioner* (Sept. 9, 1939) 40 B.T.A. 540. Following the decision of the Board of Tax Appeals in the *Queen Insurance Company* case, *supra*, the Board held in that case that the total amount of income taxes due under the Canadian Income War Tax Act, including the amount of tax credited but originally paid as a premium tax under the Special War Revenue Act, was a proper credit under the provisions of Section 131(a)(1) I.R.C. In that case, however, there were two companies whose premium taxes under the Canadian Special War Revenue Act had exceeded the amount of their income taxes due under the provisions of the Canadian Income War Tax Act. With respect to these companies the board was called upon

to specifically decide whether or not the Canadian Special War Revenue Tax was an income tax for which a credit could be allowed under the provisions of Section 131(a)(1). The board concluded that the Canadian Special War Revenue Tax was not an "income tax" within the meaning of that term as used in the Internal Revenue Code and held for that reason it could not be allowed as a foreign tax credit under Section 131(a)(1) I.R.C. The net effect of the decision of the board in that case was to hold that the Canadian Special War Revenue Tax could be allowed indirectly but not directly, as a foreign tax credit under Section 131(a)(1) I.R.C. It altered somewhat the effect of its decision in the case of *U. S. Fidelity & Guaranty Company, supra.* It confirmed in part and rejected in part the Commissioner's ruling in I.T. 3138, 1937-2, C.B. 230 (Appendix No. XXI).

An appeal was taken from the Board's decision in the case of *Queen Insurance Company of America v. Commissioner, supra.* The decision of the Board in that case was reversed by the Circuit Court of Appeals in the case of *Helvering v. Queen Insurance Company* (1940) 115 F.(2d) 341, 25 A.F.T.R. 996. The decision of the court in that case is not very enlightening because of its brevity. It held that the taxpayer could claim a foreign tax credit under the provisions of Section 131(a)(1) I.R.C., only for the amount of tax actually paid as income tax under the provisions of the Canadian Income War Tax Act. The court held this did not include the amount deducted by the taxpayer from its Canadian income tax for the Special War Revenue Tax which it had paid. In that case the tax-

payer had conceded that the Canadian Special War Revenue Tax, as such, could not be allowed as a foreign tax credit under the provisions of Section 131(a)(1) I.R.C. That case confirmed in part and overruled in part the board's decision in the case of *Continental Insurance Company v. Commissioner*, *supra.* It was not until 1940 that the case law dealing with the Canadian Special War Revenue Tax held that such tax could not be allowed indirectly as a foreign tax credit under the Internal Revenue Code.

Two years later a Federal District Court in Minnesota decided the case of *St. Paul Fire & Marine Insurance Co. v. Reynolds* (March 9, 1942) 44 F. Supp. 863, 29 A.F.T.R. 592. In that case for the first time it was unequivocally held that the Canadian Special War Revenue Tax could not be allowed either directly or indirectly as a foreign tax credit under Section 131(a)(1) of the Revenue Acts of 1932 and 1934. Since the decision of the court in that case there have been no further cases dealing with the Canadian Special War Revenue Tax as a tax credit. This historical data is most significant. It indicates that from 1918 to 1937 the practice of the Commissioner and the courts was to allow the Canadian Special War Revenue Tax as a credit against taxpayers' United States income tax. From 1937 to 1939 the Canadian Special War Revenue Tax was not allowed as a foreign tax credit because of a ruling of the Commissioner. The issue was not then settled. From 1939 to the decision of the Circuit Court in the case of *Helvering v. Queen Insurance Company* in 1940 the Canadian Special War Revenue Tax was *indirectly* allowed as a foreign

tax credit under Section 131(a)(1). It was not until March 9, 1942, that the case law on the subject definitely established that the Canadian Special War Revenue Tax could not be allowed either directly or indirectly as a foreign tax credit.

As previously indicated herein, less than seven months after a Federal District Court, for the first time, had unequivocally held that the Canadian Special War Revenue Tax could not be allowed, either directly or indirectly, as a foreign tax credit under Sction 131(a)(1), the Senate Finance Committee sired the amendment that added subsection (h) to Section 131 I.R.C. The expression of purpose of the Committee quoted at length in previous parts of appellant's brief indicates Congress intended to repudiate the basis of the court's decision in the case of *St. Paul Fire & Marine Insurance Company v. Reynolds, supra.* As previously indicated, Congress must be presumed to have intended to change, not only the statutory, but also the case law interpreting it (Citation of Authorities at pages 29, 30). In 1942 Congress knew that between 1940 and 1942 the courts had construed the foreign tax credit provision of the Internal Revenue Code so strictly that they were thwarting its salutary purpose. Subsection (h) was accordingly added to Section 131 I.R.C., to remedy that situation. The Congressional committee which sired the amendment which added subsection (h) to Section 131, likewise sired the amendment to Section 207, making mutual insurance companies, such as appellant, subject to tax on a gross income basis. While Section 207 was added to raise additional revenue,

subsection (h) was added to Section 131, to give to taxpayers such as appellant, which were taxed in foreign countries on a gross income basis, greater, not less, relief from the oppressive burden of foreign taxation. *Burnet v. Chicago Portrait Company* (1932) 285 U.S. 1, 15, 76 L. ed. 587, 594, 10 A.F.T.R. 800.

(b)

The standards and tests employed by the Courts in those cases in which the Special War Revenue Tax was denied as a foreign tax credit indicate appellant is entitled to the foreign tax credit claimed.

In construing the foreign tax credit provisions of U. S. Revenue acts prior to 1942 the term "income tax" as used therein was construed to mean a tax on income as that term was used and understood in U. S. tax law. In 1942 at the time of the addition of subsection (h) to Section 131 I.R.C., to be allowed as a foreign tax credit the foreign tax had to qualify as a tax on "income" as that term was understood and employed in the U. S. tax law.

Biddle v. Commissioner (1938) 302 U.S. 573, 82 L. ed. 431, 58 S. Ct. 379, 19 A.F.T.R. 1253;

St. Paul Fire & Marine Insurance Co. v. Reynolds (1942) 44 F. Supp. 863, 865, 29 A.F.T.R. 592.

A succinct digest of reported cases construing foreign tax credit provisions of the Internal Revenue Code will be found in Appendices Nos. XXIII and XXIV. An analysis of those cases indicates that "income tax" as that term was employed in the U. S. tax

laws prior to 1942 was a direct tax on "income." The term "income" as employed in U. S. tax law prior to the amendment of Section 207 in 1942 was uniformly restricted to a gain realized or a profit derived from capital, labor or both. As observed, from 1940 up to the addition of subsection (h) to Section 131 in 1942 this test was applied by the courts with strictness, and unless the foreign tax under consideration clearly constituted a net income tax on "profits" it was not allowed as a foreign tax credit.

In 1942 the amendment of Section 131(h) and Section 207 made fundamental changes in the U. S. tax law. At that time Congress either intended to approve or repudiate the foreign tax credit test that had been previously employed by the courts. In either event appellant is entitled to the foreign tax credit claimed. If this test is properly employed in this case it must be recognized that the term "income tax" as that term is understood and used in U. S. tax law changed with the 1942 amendment to Section 207. Now the term "income tax" as understood in U. S. tax law may include a tax on gross amount of income as well as "net income." In the application of the test, if cognizance is taken of this fact and the test is strictly applied as it was prior to 1942 it is clear, as previously indicated, that the taxes paid in the United States by appellant under the provisions of Section 207 on the gross amount of income are not "income taxes." If they are not "income taxes" within the meaning of the U. S. tax law they must be taxes paid in lieu of an income tax otherwise generally imposed within the meaning of Section 131(h). For the same reason,

where it appears as it does in this case that appellant, in Canada, did not pay the ordinary type of "net income tax," but instead paid substantially a gross income tax on net premiums under the Special War Revenue Act the Canadian tax constitutes a tax in lieu of an income tax otherwise generally imposed. That is true if the former test is strictly applied.

If the former test is properly applied appellant is entitled to a foreign tax credit under the provisions of either subsection (a) (1) or subsection (h) of Section 131.

In previous parts the similarity between the basis of appellant's tax in the United States and Canada for the year 1942 was discussed. In both countries for that period appellant was taxed on substantially a gross income basis without regard to whether or not appellant had earned a profit in either Canada or the United States. On June 1, 1948, the Second Circuit Court of Appeals decided the case of *New York & Honduras Rosario Mining Co. v. Commissioner* (1948) 168 F.(2d) 745, 747, 36 A.F.T.R. 1115. In that case appellant taxpayer was claiming foreign tax credits under the provisions of Section 131(a) (1) for the years 1941 and 1942. The tax for which appellant claimed credit was substantially a gross income tax imposed by the Republic of Honduras. The Tax Court had denied appellant's foreign tax credit claim on the ground that the Honduras tax was an excise tax. In overruling the decision of the Tax Court the Court of Appeals stated:

> "Hence, the ultimate question for determination is whether the foreign tax is the *substantial*

equivalent of an 'income tax' as that term is understood in the United States." (Italics ours)

The basis on which this appellant was taxed in 1942 under our own tax law cannot be ignored. Because, the tax paid by appellant to Canada was "substantially equivalent" to the income tax appellant paid in the United States it would qualify the appellant for the foreign tax credit claimed under the provisions of Section 131(a)(1) I.R.C.

Appellant did not choose to claim the foreign tax credit under that section. Appellant claimed its foreign tax credit under the provisions of Section 131(h) because subsection (h) was added to Section 131 in 1942 by the same Congress that subjected appellant, in the United States, to a gross amount of income tax under Section 207 I.R.C. The very close relationship between these amendments in fact and in point of time indicate that Congress was cognizant of the fact that where mutual insurance companies such as appellant paid their tax on the "gross amount of income" basis they were not paying an "income tax" within the meaning of that phrase as it had been previously understood in the U. S. tax law. Congress for that reason specifically intended that if any foreign country should impose upon mutual insurance companies or any other organization a tax on a similar basis it should be allowed as a foreign tax credit as a tax "in lieu of" a tax on "income" as that term had theretofore been understood. Because the tax for which appellant claims credit is a tax imposed by a foreign country on a basis similar to its basis of tax under Section 207 I.R.C., it is precisely the kind of tax that

Congress intended to allow as a foreign tax credit under Section 131(h) I.R.C.

(c)

The pertinent cases decided since 1942 indicate appellant is entitled to the foreign tax credit claimed.

Since the amendment in 1942 to Section 131 I.R.C. and Section 207 I.R.C. the only pertinent cases construing the provisions of Section 131 I.R.C. are the United States Court of Appeals case of *New York & Honduras Rosario Mining Co. v. Commissioner* (1948) 168 F.(2d) 745, 36 A.F.T.R. 1115, and the decision of the Tax Court in this case referring to it.

In its decision in this case the Tax Court sought to distinguish appellant's case from the case of *New York & Honduras Rosario Mining Co. v. Commissioner*, supra, solely on the ground that the latter case involved a credit claimed under Section 131(a)(1) and held that the foreign tax credit claimed should be allowed because the foreign tax was "an income tax" within the meaning of that section. That case should not have been disposed of by the Tax Court so summarily. In fact it supports appellant's case.

In that case, for the years 1941 and 1942 the taxpayer had claimed a foreign tax credit under the provisions of Section 131(a)(1) for taxes paid to the Republic of Honduras at the rate of 7% of its liquid profits from the exploitation of mines in that country. On June 23, 1947, the Tax Court in its decision reported in 8 T.C. 1232 denied the foreign tax credits claimed by the taxpayer. In its decision the Tax Court had held that the Honduras tax was an "excise tax"

imposed upon the privilege of exploiting the mining properties within that country, and for that reason were not "income taxes" within the meaning of Section 131(a)(1) I.R.C. In that case the Tax Court denied the taxpayers' foreign tax credits for the same reasons that the Tax Court denied the foreign tax credits claimed by appellant in this case. As previously observed, the United States Court of Appeals (2d Circuit) in that case reversed the decision of the Tax Court and allowed the taxpayer the foreign tax credits claimed under the provisions of Section 131(a)(1) I.R.C. The test employed by the court in that case has already been mentioned. In applying that test the court in that case observed that the purpose of Section 131(a)(1) was to "mitigate the evil of double taxation of domestic corporations on income derived from foreign sources." Citing the case of *Flint v. Stone Tracy Company* (1911) 220 U.S. 107, 145, 31 S. Ct. 342, 55 L. ed. 389, 3 A.F.T.R. 2834, the court stated that what a tax is called does not determine whether it is an income tax or an excise tax. The court observed that it was significant that in Honduras law genuine excise taxes were levied which provided for a forfeiture of the mining company's franchise for failure to pay such taxes, but that with respect to the tax for which a foreign tax credit was claimed there were no forfeiture provisions for nonpayment. Conceding that the Honduras tax differed from our federal income tax the court concluded that that did not change its character as an income tax. In reversing the decision of the Tax Court Judge Swan, who wrote the opinion for the court, stated:

> "Those debits we hold were payments of income taxes to a foreign country. To hold otherwise would defeat the purpose of Section 131, which was to encourage domestic corporations to do business abroad without having to operate through a foreign corporation, the inducement being that there income from operations abroad should be taxed only once."

The same compelling reasons exist in this case as in that for the allowance of the foreign tax credit claimed. In this case as in that one in the foreign law which imposed the tax for which a credit is claimed there is no forfeiture provision for the non-payment of such tax (Appendix No. XXVI). In this case, as in that one to deny the appellant taxpayer the foreign tax credit claimed would thwart the salutary purpose of Section 131 I.R.C. by subjecting appellant taxpayer to double taxation on its income from foreign operations.

The most recent case construing the provisions of Section 131 I.R.C. is the decision of the Tax Court in the case from which this appeal is taken. It is the only case which so far has attempted to construe the provisions of subsection (h) of Section 131 I.R.C. In its decision the Tax Court concluded that appellant could not be allowed the foreign tax credits claimed because the tax paid by it was not a tax "in lieu of an income tax otherwise generally imposed" within the meaning of subsection (h) of Section 131 I.R.C. It concluded that the tax was not a tax "in lieu of an income tax otherwise generally imposed" because: (1) The Special War Revenue Tax was enacted prior to the Canadian Income War Tax Act; (2) In 1946

when appellant became subject to taxation under the Canadian Income War Tax Act the Special War Revenue tax on premiums was not removed; (3) Prior to the enactment of subsection (h), *supra*, it had been held that the Canadian premium tax was not an income tax within the meaning of Section 131(a)(1) of the revenue acts of 1932 and 1934, which was similar to Section 131(a)(1) I.R.C. of 1942 and 1943. Citing the cases of *St. Paul Fire & Marine Insurance Co. v. Reynolds, supra; Continental Insurance Co. v. Commissioner, supra*, and *Helvering v. Queen Insurance Co., supra*, the Tax Court concluded that the tax for which appellant claimed a foreign tax credit was an "excise tax," and for that reason could not be allowed as a foreign tax credit under Section 131(h) I.R.C.

Each one of the reasons upon which the Tax Court based its decision in this case is a plausible reason why the appellant is entitled to the foreign tax credit claimed.

(1) *The Special War Revenue Tax was enacted prior to the Canadian Income War Tax Act.* This is the strongest kind of evidence that at that time the Special War Revenue Tax was a tax "in lieu of an income tax" for all insurance companies to which it applied. The formulation of a satisfactory net income tax law is an intricate and difficult undertaking. The formulation and collection of a gross income tax is comparatively simple. As previously observed, in our own law all insurance companies and business corporations were subjected to a gross income tax under the special excise tax law of 1909 (36 Stat. at L. 11, 112—117, ch. 6 U.S. Comp. Stat. Supp. 1909, pages

659, 844, 849) before the enactment of a general net income tax law. As previously observed, when a general net income tax law was enacted in Canada as in the United States, mutual insurance companies such as appellant were not subject to taxation thereunder. But in Canada, at the time of the adoption of the Income War Tax Act in 1917, the Special War Revenue Tax was continued with respect to insurance companies operating for profit as joint stock companies. The Income War Tax Act, however, provided that such companies could deduct from the amount of their net income tax otherwise payable the amount of tax they had paid under the Special War Revenue Tax. As previously observed, up to 1940 such companies were thus able to indirectly claim the Special War Revenue Tax as a foreign tax credit as an income tax paid to a foreign country. Not being subject to the general income tax law of either Canada or the United States during that period, mutual insurance companies operating in Canada, paid the Special War Revenue Tax during that entire period as a tax "in lieu of an income tax" within the literal meaning of that phrase. The 1942 amendment to the Canadian Special War Revenue Act did not change its character. So far as mutual insurance companies were concerned it always had been a tax "in lieu of" an income tax. After 1942 it continued to be a tax "in lieu of" an income tax for mutual insurance companies such as appellant.

(2) *In 1946 when appellant became subject to the Canadian Income War Tax Act the Special War Revenue Tax on premiums was not removed.* That is un-

disputed. Appellant is not contending, however, that the Canadian Special War Revenue Tax is a tax "in lieu of an income tax" in the year 1946. In the year 1946, appellant became subject to tax in the Dominion of Canada under both the Canadian Income War Tax Act and the Special War Revenue Act on the same basis as stock insurance companies and other organizations paying income taxes. For taxes paid to Canada after 1946, appellant will be able to claim foreign tax credits under the provisions of Section 131(a)(1) on the same basis as other corporations paying income taxes. Its income will thus not be subject to double taxation. The fact that up until 1946 the appellant was not subject to the same treatment under the Special War Revenue Act as other corporations which paid taxes under the Canadian Income War Tax Act strongly indicates that in 1942 and 1943, when appellant *was not* subject to the general income tax law of Canada, the Special War Revenue Tax, with respect to its application to the appellant, was a tax "in lieu of" an income tax.

(3) *Prior to the enactment of subsection (h) it had been held that the Canadian premium tax was not an income tax within the meaning of Section 131(a)(1) of the revenue acts of 1932 and 1934 (similar to Section 131 (a)(1) I.R.C.), but was in the nature of an excise tax.* This reason assigned by the Tax Court for its decision was based entirely upon the cases of *St. Paul Fire & Marine Insurance Co. v. Reynolds, Continental Insurance Company v. Commissioner,* and *Helvering v. Queen Insurance Company,* all of which have been discussed at length herein. As previously

pointed out, the expressed intent of Congress in adding subsection (h) to Section 131 I.R.C. was to repudiate the basis of decisions of the courts in those cases. In the Canadian Special War Revenue Tax Law there is no provision in any section that states that it is imposed upon insurance companies for the privilege of exercising their franchise in the Dominion of Canada. There is no section in that law that provides for the revocation of a company's franchise for a failure to pay the tax (See Appendix No. XXVI).

Unless appellant is allowed the foreign tax credit claimed appellant's Canadian income in the amounts of $509,072.00 and $540,084.67 for 1942 and 1943 respectively, will be subject to double taxation and the worthwhile purpose of Congress in enacting Section 131 will be defeated. Unless appellant is allowed the foreign tax credit claimed the attempt by Congress to amend and liberalize that section to enable it thereby to carry out its purpose more effectively will be completely thwarted. The applicable case law, for the reasons set forth herein, indicates that to implement and give effect to the purpose of Congress appellant must be allowed the foreign tax credits claimed.

Section G

ARGUMENT

Limitation Feature

Section 131(b) of the Internal Revenue Code Requires the Use of Appellant's "Normal-Tax Net Income" (Investment Income) as the Basis for Computing the Limitation on Appellant's Foreign Tax Credit.

I.

The Internal Revenue Code provides that "normal-tax net income" is the basis for the computation of the limitation on foreign tax credit in the case of a corporation.

The applicable section of the Internal Revenue Code is Section 131 (a) (b). It was amended by Sections 158(a) and 158(b), of the 1942 Revenue Act. As amended, Section 131(b) provides as follows:

> "(b) LIMIT OF CREDIT. The amount of the credit taken under this section shall be subject to each of the following limitations:
>
> "(1) The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's net income from sources within such country bears to his entire net income in the case of a taxpayer other than a corporation or to the sum of the *normal-tax net income* and the amount of the credit for adjusted excess profits net income provided in Section 26(e) in the case of a corporation for the same taxable year; and
>
> "(2) The total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's net income from sources without the United

States bears to his entire net income, in the case of a taxpayer other than a corporation, or to the sum of the *normal-tax net income* and the amount of the credit for adjusted excess profits net income provided in Section 26(e) in the case of a corporation for the same taxable year." (Italics ours)

Prior to the 1942 amendment subparagraphs (1) and (2) of Section 131(b) read as follows:

"(1) The amount of the credit in respect of the tax paid or accrued to any foreign country shall not exceed * * * in the case of a corporation the same proportion of the tax against which such credit is taken which the taxpayer's *normal-tax net income* from sources within such country bears to its entire normal tax net income for the same taxable year; and

"(2) The total amount of the credit shall not exceed, * * * the same proportion of the tax against which such credit is taken which the taxpayer's *normal-tax net income* from sources without the United States bears to its entire normal-tax net income for the same taxable year; * * *." (Italics ours)

By its express provisions the calculation of the limitation on foreign tax credit must be based on the "normal-tax net income" of the taxpayer. The language of the section, both prior to the 1942 amendment and as amended in 1942, is very clear and unambiguous on this point. For that reason there is no reason to judicially construe it.

II.

The Commissioner's regulations provide that "normal-tax net income" is the basis for the computation of the limitation on foreign tax credits in the case of a corporation.

Following the 1942 amendment to Section 131(b) the Commissioner issued Regulation 103, Section 19.131.8 , giving his department's interpretation of the statute as amended. According to the Commissioner's regulation the amount of the income and excess profits tax paid or accrued during the taxable year to each foreign country is limited under Section 131(b) by each of the following in the case of a corporation (see Appendix IX):

(1) The credit for taxes paid to any one country shall not exceed the proportion of the U. S. income tax against which the credit is taken which the corporation's *normal-tax net income* from sources within the foreign country bears to its entire *normal-tax net income* for the same taxable year;

(2) And the aggregate credit shall not exceed the proportion of the U. S. income tax which the *normal-tax net income* from all sources without the U. S. bears to the entire *normal-tax net income* for the same taxable year. (Italics ours)

For the purpose of computing the credit in the case of a corporation for a taxable year beginning after December 31, 1941, normal-tax net income from the foreign country or from outside the U. S. means net income from such sources minus the same proportion of the credit under Code Section 26(e) (for adjusted excess profits net income) which the taxpayer's excess

profits net income from such sources bears to its entire excess profits net income for the same taxable year. While the excess profits feature of the regulation is of interest it is only indirectly pertinent because appellant did not pay any excess profits tax either within or outside of the United States for the taxable years 1942 and 1943.

Since each of these limitations is applicable the calculation under each gives in effect a tentative credit; the allowable credit is that amount which produces the smaller credit. That amount may be applied as a credit against the taxpayers' U. S. income for income or excess profits taxes paid or accrued to a foreign country.

This regulation is very largely a paraphrasing of the wording of the statute itself. It indicates that in the case of a corporation for the taxable years beginning after December 31, 1939, and prior to January 1, 1942, "*the normal-tax net income*" is the basis for the credit, and that for taxable years beginning after December 31, 1941, the "*normal-tax net income*" and the amount of credit for "*adjusted excess profits net income*" forms the basis for the credit. Since the appellant during the tax years 1942 and 1943, did not pay an excess profits tax under Section 26(e) and therefore is not entitled to any credit for adjusted excess profits tax, in accordance with 26(e), appellant's "*normal-tax net income*" formed the sole basis for the computation of the limitation on its foreign tax credit according to the terms of the Commissioner's regulation.

III.

Appellant's "normal-tax net income" as shown on its income tax return form 1120 M is its only statutory "normal-tax net income" and therefore must be the basis for the computation of the limitation on its foreign tax credit.

As previously mentioned in a preceding part, prior to 1942 mutual fire insurance companies such as the appellant were either exempt from income tax under Section 101(11) (Appendix No. XVII) and corresponding provisions of earlier revenue acts, or no income tax was ordinarily paid by them under Section 207 (see Report of Committee on Ways and Means, Cumulative Bulletin 1942-3, Sec. 147 pp. 395 and 456 Appendix No. VIII).

The Revenue Act of 1942, also discussed in a preceding part, amended Section 101(11) to limit the exemption of mutual fire insurance companies, such as appellant to those companies with an annual gross income of $75,000 or less, thus causing all of the larger mutual fire insurance companies to become taxable under Section 207 (Appendices Nos. VIII and XVIII).

The Revenue Act of 1942 also amended Section 207 by repealing the former provision under which mutual fire insurance companies such as the appellant ordinarily paid no income tax. As previously pointed out in another part, in its place there was enacted an entirely new tax plan for such mutual insurance companies. That plan is unique in Federal Income Tax Law. Under Section 207 as amended, mutual fire insurance companies are taxed:

(1) On net investment income at corporation tax rates; or

(2) On gross amount of income at the rate of 1%. taxes being payable on whichever of the two plans produces the greater tax.

A mutual insurance company taxable under Section 207 must make both tax calculations indicated above as (1) and (2) for each tax year on form 1120M. Then it pays whichever of the two taxes is the greater.

The Commissioner has developed a special income tax return for mutual fire insurance companies taxable under Section 207. It is Form 1120M. On this return a mutual company develops its net income from interest, dividends, rent and capital gains. From such net income it develops its normal-tax net income and its surtax net income. To these it applies the normal and surtax rates applicable to corporations generally. The tax on net investment income is thus computed.

Form 1120M also provides for the computation of the tax on "gross amount of income" at 1%. "Gross amount of income," as previously indicated, is composed of net premiums and gross investment income.

Having made both of the two separate calculations on Form 1120M the mutual company takes the greater figure as its federal income tax before the application of any foreign tax credit. If a foreign tax credit is available to the mutual insurance company this is the final calculation on Form 1120M.

The examination of any mutual insurance company's income tax return for a single year will reveal whether the amount of its Federal income tax for that

year is the result of the investment income basis of computation, or the gross amount of income 1% computation, but the final figure, whichever it may be, is that mutual company's Federal income tax.

Thus one of the prerequisites for the determination of appellant's tax under Section 207 I.R.C. is for it to determine and report its "normal-tax net income" as required by Section 207(a) (1) (A) (Appendix No. II).

This normal-tax net income is always computed on the basis of the investment income. For mutual insurance companies other than life or marine Section 207 (b) I.R.C. (Appendix No. III) gives the statutory definition of income of such companies. It defines gross investment and net income of mutual insurance companies, other than life or marine, such as appellant. From that definition it is necessary to turn to Section 13(a) (Appendix No. IV) to arrive at the statutory definition of "normal-tax net income."

Where a mutual fire insurance company, such as appellant, pays its Federal income tax under the provisions of Section 207, on the basis of its net investment income at corporate rates (because that basis had produced the higher tax) the normal-tax net income serves directly to produce the figure for which income tax is payable. According to the position taken by the Commissioner he would not, under such circumstances, question the use of appellant's normal-tax net income for purposes of computing the limitation on its foreign tax credit.

The Commissioner argues that when the circumstances are such that a corporation actually pays Fed-

eral income tax under the provisions of Section 207 on the basis of its "gross amount of income" as defined in Section 207 I.R.C. the "*gross amount of income*" should be used in the place of its *normal-tax net income* in computing the limitation upon its foreign tax credit. That is not a proper or a permissible interpretation of the provisions of the Internal Revenue Code as the law was passed by Congress.

IV.

The only permissible construction of Section 131 (b) indicates that appellant is entitled to the foreign tax credit claimed.

It is, in effect, the contention of the Commissioner that the words "*gross amount of income*" should be substituted for the words "*normal-tax net income*" where, as in the instant case, the tax which is actually paid is based upon the appellant's "gross amount of income." The law does not permit such a strained construction of the statute, nor will it permit an alteration of the plain language of the statute to conform to the contention of the Commissioner. Actually the wording of Section 131(b) is so clear that there is no need to construe it. It is only necessary to apply it. In applying it to the facts of this case it is advisable to consider that:

(1) The purpose and intention of Congress and the object of the enactment of the particular section must be considered. *Blake v. National City Bank of New York* (1875) 90 U.S. 119, 23 L. ed. 307, 2 A.F.T.R. 2339; *Burnet v. Chicago Portrait Co.* (1932) 285 U.S. 1, 76 L.ed. 587, 10 A.F.T.R. 800.

(2) The statute must be construed so as not to extend its provisions by implication beyond the clear import of the language used and in cases of doubt they are to be construed most broadly against the government and in favor of the citizen. *Gould v. Gould* (1917) 245 U.S. 151, 152, 62 L. ed. 211, 213, 3 A.F.T.R. 2958.

(3) Where the meaning of particular words are in doubt the literal or popular meaning of the words must be employed. *U.S. v Merriam* (1923) 263 U.S. 179, 187, 68 L.ed. 240, 244, 29 A.L.R. 1547, 44 Sup. Ct. 694, 4 A.F.T.R. 3673; *Crooks v. Harrelson* (1930) 282 U.S. 55, 75 L.ed. 156, 9 A.F.T.R. 571; *Deputy v. DuPont* (1940) 308 U.S. 488, 84 L.ed. 417, 23 A.F.T.R. 808.

There is only one construction of Section 131(b) that is permissible. The section must be construed to mean what it says in language that is clear and unambiguous, namely, that in the case of a corporation the limitation upon its foreign tax credit must be calculated on the basis of its normal-tax net income.

When a mutual fire insurance company, such as appellant, pays its federal income tax on the basis of net premiums plus gross investment income (gross amount of income) at the rate of 1% (where that basis produces the greater tax) its normal-tax net income does not directly produce the figure upon which the income tax is actually paid. That, however, does not form a logical basis for construing the phrase "normal-tax net income" to mean net premiums plus gross investment income when such is the actual basis of the tax paid. If Congress had so intended Congress could have so provided in language that was more clearly an expression of such intention.

The fact that Congress had no such intention is established by the report of the Committee on Finance of the Senate which indicates that the Committee gave careful consideration to the amendment of subsection (b) of Section 131 and intended the "normal-tax net income" to be the basis for the computation of the limitation factor for foreign tax credits in the case of all corporations (see Appendix XIII). If the terms of the statute are not extended by implication, indeed if the words employed are to be given their ordinary literal meaning the limitation upon appellant's foreign tax credit must be computed upon the basis of its "normal-tax net income" as developed in its returns for the years 1942 and 1943.

In this case if the limitation upon appellant's foreign tax credit is calculated on the basis of its "normal-tax net income" as produced on its returns for the years 1942 and 1943, then appellant is entitled to the full amount of the tax credit claimed (see Appendices Nos. XI and XII).

For the reasons set forth herein appellant is entitled to the full amount of the foreign tax credit claimed.

CONCLUSION

For all the reasons set forth in the preceding parts of appellant's brief it is respectfully submitted that it has been established that the Tax Court's interpretation of Section 131(h) I.R.C. was erroneous. Since the Tax Court did not express its opinion regarding the application of Section 131(b) I.R.C. it is respectfully requested that the decision of the Tax Court be reversed, and that this court determine that under Section 131 I.R.C. appellant is entitled to the full amount of the foreign tax credit claimed.

It is therefore respectfully requested that this court enter judgment in favor of the appellant, setting aside the deficiencies in appellant's income taxes in 1942 and 1943 in the respective amounts of $5,089.03 and $5,347.81, and allowing appellant income tax refunds for those years in the amounts of $10,183.13 and $10,854.73, respectively.

Respectfully submitted,

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APPENDICES

Preface

These appendices are furnished with Appellant's brief to facilitate this Court's reference to the pertinent regulations, statutes and reports referred to in Appellant's brief.

Appendices Nos. I - VI inclusive, and XV - XVIII inclusive, contain the pertinent provisions of the credit and limitation features of the Internal Revenue Code, the provisions of the section under which Appellant was taxed, and all other sections to which reference is necessary in determining Appellant's foreign tax credits.

Appendices Nos. VII - X inclusive, and XIII and XIV set forth the pertinent regulations in toto, with quotations at length from appropriate Cumulative Bulletins.

For the convenience of the Court, Appendices Nos. XI and XII summarize in tabular form what Appellant contends is the correct manner of calculating the amount of Appellant's foreign tax credit for 1942 and 1943.

The history of the taxation of insurance companies, stock and mutual, in Canada and the United States is concisely summarized in tabular form in Appendix No. XIX.

Appendices Nos. XX - XVII inclusive, summarize as concisely as possible all pertinent rulings of the Commissioner of Internal Revenue.

In Appendices Nos. XXIII and XXIV the pertinent case law is succinctly digested.

Wherever excerpts are quoted in the brief an effort has been made to set forth at length in these appendices the entire quotation from which they were taken. Appendix No. XXV contains pertinent quotations from the Canadian Parliamentary debates.

Appendix No. XXVI contains the penalty provision of the Canadian Special War Revenue Act.

APPENDIX No. 1

"SUPPLEMENT C - - - CREDITS AGAINST TAX TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES

"Sec. 131(a)

"(a) ALLOWANCE OF CREDIT.—If the taxpayer chooses to have the benefits of this section, the tax imposed by this chapter, except the tax imposed under section 102 or section 450, shall be credited with:

> "(1) CITIZENS AND DOMESTIC CORPORATIONS.—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and * * *

"Such choice may be made or changed at any time prior to the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter."

"Sec. 131(b)

"(b) LIMIT ON CREDIT.—The amount of the credit taken under this section shall be subject to each of the following limitations:

> "(1) The amount of the credit in respect of the tax paid or accrued to any country shall not exceed, in the case of a taxpayer other than a corporation, the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources within such country bears to his entire net income for the same taxable year, or in the case of a corporation, the same proportion of the tax against which such credit is taken, which the taxpayer's normal-tax net income from sources within such country bears to its entire normal-tax net income for the same taxable year; and

"(2) The total amount of the credit shall not exceed, in the case of a taxpayer other than a corporation, the same proportion of the tax against which such credit is taken, which the taxpayer's normal-tax net income from sources without the United States bears to its entire normal-tax net income for the same taxable year; and

"Sec. 131(h)

"(h) CREDIT FOR TAXES IN LIEU OF INCOME, ETC., TAXES.—For the purposes of this section and section 23(c)(1), the term 'income, war-profits, and excess-profits taxes' shall include a tax paid in lieu of a tax upon income, war-profits, or excess-profits otherwise generally imposed by any foreign country or by any possession of the United States."

APPENDIX No. II

"MUTUAL INSURANCE COMPANIES OTHER THAN LIFE OR MARINE

"Sec. 207(a)

"(a) IMPOSITION OF TAX.—There shall be levied, collected, and paid for each taxable year upon the income of every mutual insurance company (other than a life or a marine insurance company or a fire insurance company subject to the tax imposed by section 204 and other than an interinsurer or reciprocal underwriter) a tax computed under paragraph (1) or paragraph (2) whichever is the greater and upon the income of every mutual insurance company (other than a life or marine insurance company or a fire insurance company subject to the tax imposed by section 204) which is an interinsurer or reciprocal underwriter, a tax computed under paragraph (3):

"(1) If the corporation surtax net income is over $3,000 a tax computed as follows:

"(A) Normal Tax.—A normal tax on the normal-tax net income, computed at the rates provided in section 13 or section 14(b), or 30 per centum of the amount by which the normal-tax net income exceeds $3,000, whichever is the lesser; plus

"(B) Surtax.—A surtax on the corporation surtax net income, computed at the rates provided in section 15(b), or 20 per centum of the amount by which the corporation surtax net income exceeds $3,000, whichever is the lesser.

"(2) If for the taxable year the gross amount of income from interest, dividends, rents and net premiums, minus dividends to policyholders, minus the interest which under section 22(b)(4) is excluded from gross income, exceeds $75,000, a tax equal to the excess of —

"(A) 1 per centum of the amounts so computed, or 2 per centum of the excess of the amount so computed over $75,000, whichever is the lesser, over

"(B) the amount of the tax imposed under Subchapter E of Chapter 2."

APPENDIX No. III

"MUTUAL INSURANCE COMPANIES OTHER THAN LIFE OR MARINE

"Sec. 207(b)

"(b) DEFINITION OF INCOME, ETC.—In the case of an insurance company subject to the tax imposed by this section —

"(1) GROSS INVESTMENT INCOME. — 'Gross investment income' means the gross amount of income during the taxable year from interest, dividends, rents, and gains from sales or exchanges of capital assets to the extent provided in section 117;

"(2) NET PREMIUMS. — 'Net premiums' means gross premiums (including deposits and assessments) written or received of insurance contracts during the taxable year less return premiums and premiums paid

or incurred for reinsurance. Amounts returned where the amount is not fixed in the insurance contract but depends upon the experience of the company or the discretion of the management shall not be included in return premiums but shall be treated as dividends to policyholders under paragraph (3);

"(3) DIVIDENDS TO POLICYHOLDERS.—'Dividends to policyholders' means dividends and similar distributions paid or declared to policyholders. The term 'paid or declared' shall be construed according to the method regularly employed in keeping the books of the insurance company;

"(4) NET INCOME.—The term net income means the gross investment income less —

"(A) Tax-free Interest. * * *

"(B) Investment Expenses. * * *

"(C) Real Estate Expenses. * * *

"(D) Depreciation. * * *

"(E) Interest Paid or Accrued. * * *

"(F) Capital Losses. * * *"

APPENDIX No. IV

"TAX ON CORPORATIONS IN GENERAL

"Sec. 13(a)

"(a) DEFINITIONS. — For the purpose of this chapter —

"(1) ADJUSTED NET INCOME.—The term 'adjusted net income' means the net income minus the credit provided in section 26(a), relating to interest on certain obligations of the United States and Government corporations.

"(2) NORMAL-TAX NET INCOME. — The term 'normal-tax net income' means the adjusted net income minus the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26(e) and minus the credit for dividends received provided in section 26(b)."

"Sec. 13(b)

"(b) IMPOSITION OF TAX.—There shall be levied, collected, and paid for each taxable year upon the normal-tax net income of every corporation the normal-tax net income of which is more than $25,000 (except a corporation subject to the tax imposed by section 14, section 231(a), Supplement G, or Supplement Q) whichever of the following taxes is the lesser:

"(1) GENERAL RULE.— A tax of 24 per centum of the normal-tax net income; or

"(2) ALTERNATE TAX (CORPORATIONS WITH NORMAL-TAX NET INCOME OVER $25,000 BUT NOT OVER $50,000).—A tax of $4,250, plus 31 per centum of the amount of the normal-tax net income in excess of $25,000."

APPENDIX No. V
"SURTAX ON CORPORATIONS

"Sec. 15(a)

"(a) CORPORATION SURTAX NET INCOME.—For the purposes of this chapter, the term 'corporation surtax net income' means the net income minus the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26(e) and minus the credit for dividends received provided in section 26(b) (computed by limiting such credit to 85 per centum of the net income reduced by the credit for income subject to the tax imposed by Subchapter E of Chapter 2 in lieu of 85 per centum of the adjusted net income so reduced), and minus, in the case of a public utility, the credit for dividends paid on its preferred stock provided in section 26(h). For the purposes of this subsection dividends received on the preferred stock of a public utility shall be disregarded in computing the credit for dividends received provided in section 26(b).

"Sec. 15(b)

"(b) IMPOSITION OF TAX.—There shall be levied, collected, and paid for each taxable year upon the corporation surtax net income of every corporation (except a Western Hemisphere Trade Corporation as defined in section 109, and except a corporation subject to the tax imposed by section 231(a), Supplement G, or Supplement Q), a surtax as follows:

"1. Surtax net income not over $25,000. * * *

"2. Surtax net incomes over $25,000 but not over $50,000. * * *

"3. Surtax net incomes over $50,000.—Upon corporation surtax net incomes over $50,000, 16 per centum of the corporation surtax net income."

APPENDIX No. VI

"CREDITS OF CORPORATIONS

"Sec. 26(a)

"(a) INTEREST ON OBLIGATIONS OF THE UNITED STATES AND ITS INSTRUMENTALITIES.—The amount received as interest upon obligations of the United States or of corporations organized under Act of Congress which is allowed to an individual as a credit for purposes of normal-tax by section 25(a)(1) or (2). (For reduction of credit under this subsection on account of amortizable bond premium, see section 125).

"Sec. 26(b)

"(b) DIVIDENDS RECEIVED.—85 per centum of the amount received as dividends from a domestic corporation which is subject to taxation under this chapter, but not in excess of 85 per centum of the adjusted net income reduced by the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in subsection (e).

The credit allowed by this subsection shall not be allowed in respect of dividends received from a corporation organized under the China Trade Act, 1922, 42 Stat. 849 (U.S.C., Title 15, C. 4), or from a corporation which under section 251 is taxable only on its gross income from sources within the United States by reason of its receiving a large percentage of its gross income from sources within a possession of the United States."

"Sec. 26(e)

"(e) INCOME SUBJECT TO EXCESS-PROFITS TAX.—In the case of any corporation subject to the tax imposed by Subchapter E of Chapter 2, an amount equal to its adjusted excess-profits net income (as defined in section 710(b). * * *"

Subchapter E of Chapter 2 * * * Excess Profits Tax.

APPENDIX No. VII

"III.—TAXATION OF CERTAIN TYPES OF CORPORATIONS

"2. MUTUAL INSURANCE COMPANIES OTHER THAN LIFE.—

"The revenue derived from mutual insurance companies is negligible. The reason lies in the broad language of the exception provision and in the ineffective language of the taxing provisions. Section 144 of the bill makes the exemption provision explicit, limiting it to companes of designated size. It also completely revises the taxing provisions, basing the levy on underwriting and investment income, in a manner similar to that applied to stock insurance companies other than life. At the same time due regard is given the mutual character of these companies through the reduction of underwriting income by dividends to policyholders out of premiums and surplus apportioned to them,

and by additions to surplus apportioned to policyholders." Cumulative Bulletin 1942-2, p. 395.

APPENDIX No. VIII

Cumulative Bulletin 1942-2, p. 456.

"Section 147.—MUTUAL INSURANCE COMPANIES OTHER THAN LIFE. —

"Most mutual insurance companies other than life, large as well as small, are given an outright exemption from taxation under section 101(11), although that section was originally designed to exempt only small and local mutual companies. The remaining mutual companies, with a few exceptions, ordinarily pay no tax under the present method of computing their income even though not specifically exempted from the tax.

"The exemption provided in section 101(11) has been revised so that it will be limited to mutual companies or associations (including interinsurers and reciprocal underwriters) writing insurance contracts solely on a mutual basis, if the mean of the ledger assets held at the beginning and end of the taxable year does not exceed $100,000. Practically all of the farmers' and other small and local mutual companies have ledger assets of less than $100,000 and accordingly will not be required to file income tax returns or pay any income taxes. It is estimated that over 80 per cent of all companies will be exempt from filing returns under this provision. In addition, even where ledger assets exceed $100,000, and an income tax return must be filed, it is provided under section 207(a) that no income tax is payable unless the corporation surtax net income (which may be greater than, but can never be less than, the normal tax net income) is over $50,000. Only the larger companies will pay a tax under these provisions. Accord-

ingly, these provisions will impose no hardship upon farmers' or other small and local mutual insurance companies other than life.

"In case of mutual insurance companies other than life which are not granted exemption under section 101(11), it is proposed to subject such companies to income tax on the sum of their investment and underwriting income in a manner somewhat similar to that used under section 204 (relating to insurance companies other than life or mutual). * * *"

APPENDIX No. IX

"Reg. 103, Sec. 19.131-8. LIMITATIONS ON CREDIT FOR FOREIGN TAXES.

"The amount of the income and profits taxes paid or accrued (including the taxes which, in accordance with the provisions of section 131(f), are deemed to have been paid) during the taxable year to each foreign country or possession of the United States, limited under section 131(b)(1) so as not to exceed that proportion of the tax against which credit is taken which the taxpayer's net income from sources within such country or possession bears to (a) his entire income from sources within such country or possession bears to (a) his entire net income, or (b) for taxable years beginning after December 31, 1939, and prior to January 1, 1942, the normal-tax net income in the case of a corporation, or (c) (for taxable years beginning after December 31, 1941) the sum of the normal-tax net income and the amount of the credit for adjusted excess profits net income provided in section 26(e) in the case of a corporation, for the same taxable year, is the tentative credit in respect of the taxes paid or accrued to such country or possession. The sum of these tentative credits, limited under section 131(b)(2) so as not to

exceed the same proportion of the tax against which credit is taken which the taxpayer's net income from sources without the United States bears to (a) his entire net income, or (b) (for taxable years beginning after December 31, 1939, and prior to January 1, 1942) the normal-tax net income in the case of a corporation, or (c) (for taxable years beginning after December 31, 1941) the normal-tax net income computed without the credit for adjusted excess profits net income provided in section 26(e) in the case of a corporation, for the same taxable year, is the amount allowable as a credit against the income tax under chapter 1 for income or profits taxes paid or accrued to foreign countries or possessions of the United States. In computing the tax against which the credit is taken there must, for years beginning after December 31, 1939, and before January 1, 1943, be excluded the tax, if any, imposed by section 102, and for years beginning after December 31, 1942, there must be excluded both the tax imposed by section 102 and the tax imposed by section 450."

APPENDIX No. X

"Reg. 103, Sec. 19.131-2. MEANING OF TERMS.—The term 'amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year' means taxes proper (no credit being given for amounts representing interest or penalties) paid or accrued during the taxable year on behalf of the taxpayer claiming credit. For the purposes of section 131 and section 23(c)(1) the term 'income, war-profits and excess-profits taxes' includes, for taxable years beginning after December 31, 1941, a tax imposed by statute or decree by a foreign country or by a possession of the United States if (a) such country or possession has in force a general income tax law, (b) the taxpayer claiming the credit would, in the absence of

a specific provision applicable to such taxpayer, be subject to such general income tax, and (c) such general income tax is not imposed upon the taxpayer thus subject to such substituted tax. For example, the A Corporation does business in the X Country which imposes an income tax upon substantially a net income base. The ascertainment of net income, though not the determination of gross income, from sources in X Country is found administratively difficult. The X Country, by decree, provides that corporations circumstanced as was the A Corporation would, in lieu of the income tax at the rate of 20 per cent otherwise payable, be subject to tax at the rate of 10 per cent upon the amount of gross income from X Country. In accordance with such decree, the A Corporation paid X Country the sum of $25,000 in 1943 with respect to its tax liability to the X Country for the year 1942. Such amount, subject to the applicable limitations, is available as a credit to the A Corporation as foreign income, war-profits or excess-profits taxes against the United States tax liability for the year 1942. 'Foreign country' means any foreign state or political subdivision thereof, or any foreign political entity, which levies and collects income, war-profits, or excess-profits taxes. 'Any possession of the United States' includes, among others, Puerto Rico, the Philippines, and the Virgin Islands. But see (Code) section 251. As to the meaning of 'sources,' see (Code) section 119. (See also (Code) section 3797). (Reg. 103, Sec. 19.131-2.)''

APPENDIX No. XI

INCOME TAXES PAYABLE

Computation of Gross Amount of Income:	*Taxable Year Ended Dec. 31,* 1942	1943
Gross (investment income under section 207(a)(1) and (3), page 1 of returns as adjusted by field audit	$ 244,213.81	$ 267,519.39
Net premiums: United States	7,381,054.65	7,758,443.62
Canada, 1942—$681,111.30 converted at 90.909%	619,191.47	.....
1943—$684,416.33 converted at 90.909%	.....	622,196.04
Total gross amount of income	$8,244,459.93	$8,648,159.05
Less: Dividends to Policyholders		
United States	$1,347,259.56	$1,448,978.24
Canada, 1942—$155.242.77 converted at 90.909%	141,129.65	.....
1943—$128,382.58 converted at 90.909%	.....	116,711.32
Total dividends	$1,488,389.21	$1,565,689.56
Interest wholly exempt from tax	39,750.00	37,401.52
Total deductions from gross amount of income	$1,528,139.21	$1,603,091.08
Gross amount of income under Section 207(a)(2)	$6,716,320.72	$7,045,067.97
Computation of Tax:		
Under Section 207(a)(1) and (3):		
Normal-tax net income, item 19, page 1 of returns as accepted on field audit	$ 126,451.85	$ 151,828.23
Net income, item 14, page 1 of returns	199,657.79	224,927.98
Less: Dividends received credit	41,611.33	43,899.32
Surtax net income	$ 158,046.46	$ 181,028.66
Normal tax at 24% of normal-tax net income	30,348.44	36,438.78
Surtax at 16% of surtax net income	25,289.43	28,964.59
Total tax under Section 207(a)(1) and (3)	$ 55,635.87	$ 65,403.37
Under Section 207(a)(2):		
Gross amount of income computed above	$6,716,320.72	$7,045,067.97
Tax at 1%—being the tax payable as it is greater than that computed under 207(a)(1) and (3)	$ 67,163.21	$ 70,450.68
Less: Credit claimed for taxes paid in lieu of income taxes to Canada as provided in Section 131(h), See Appendix No. XII	15,272.16	16,202.54
Balance of tax	$ 51,891.05	$ 54,248.14

APPENDIX No. XII

CREDITS CLAIMED AGAINST INCOME TAXES

(Developed as provided on Form 1118)

	Taxable Year Ended Dec. 31 1942	1943
I. Normal-tax net income from all sources, item 19, page 1 of returns as accepted on field audit	$126,451.85	$151,928.23
II. Total United States income tax as adjusted by field audit. See Appendix No XI	$ 67,163.21	$ 70,450.68
1. Normal-tax net income from sources in Canada (ex. div.)		
1942—$41,522.85 converted at 90.909%	$ 37,748.01	
1943—$44,885.75 converted at 90.909%		$ 40,805.19
2. Dividends received from sources in Canada		
1942—$105.00 converted at 90.909%	95.45	
1943—$151.66 converted at 90.909%		137.87
3. Total normal tax net income from sources in Canada	$ 37,843.46	$ 40,943.06
4. & 7. Total of taxes paid in Canada (in lieu of income taxes)		
1942—$16,799.39 converted at 90.909%	$ 15,272.16	
1943—$17,822 81 converted at 90 909%		$ 16,202.54
8 Ratio of normal-tax net income from sources in Canada to normal-tax net income from all sources (Item 3 divided by Item I)	29.927%	26.967%
9. Amount of tax which may be claimed as credit under limitation of Section 131(b)(1) (Item II, multiplied by Item 8, unless Item 7 is less than such amount, in which case Item 7 must be used	$ 15,272.16	$ 16,202.54

APPENDIX No. XIII

Internal Revenue Bulletin, Cumulative Bulletin 1942-2

"Section 160. FOREIGN TAX CREDIT. (Page 603).

"* * *

"An amendment to subsection (b) of section 131 was found by your committee to be necessary because of the method for computing 'normal-tax net income' provided in section 105 of the bill, amending section 131(a)(2) of the Code. Under existing law in computing 'normal tax net income' the excess profits tax imposed under Chapter 2E is allowed as a deduction. Under the revenue bill of 1942, however, the adjusted excess profits net income is deducted from adjusted net income in the ascertainment of 'normal tax net income.' To preserve the appropriate ratio between the numerator and the denominator of the limitation fraction under section 131(b), it is necessary that adjusted net income be not reduced by the amount of the adjusted excess profits net income for the purpose of that section, and section 160(d) amends section 131(b) so as to accomplish such result.

"Your committee has given careful consideration to a suggested amendment to section 131 which would in substance provide that the credit for foreign taxes on foreign income not reported in the taxable year because of its being blocked should be deferred and allowed in the taxable year in which such income is released and realized for income tax purposes. The committee has not adopted such an amendment for the reason that it believes the amendment to be unnecessary. Under a proper interpretation of existing law, the credit for foreign taxes, as well as the various allowable deductions, follows the income into the taxable year in which it is realized for purposes of the income tax law. The committee feels, in view of the importance of this

question to a large number of taxpayers, that the matter is one which it would be appropriate to cover specifically by departmental regulation.''

Senate Finance Committee, Senate Report No. 1631, Seventy-seventh Congress, Second Session Calendar No. 1683 (October 2, 1942).

APPENDIX No. XIV

''Internal Revenue Bulletin, Cumulative Bulletin 1942-2, Sec. IV. TAXATION OF CERTAIN TYPES OF CORPORATION. §1. Mutual Insurance Companies Other Than Life or Marine. Page 531.

''Under the House bill, mutual insurance companies other than life were to be taxed on the basis of their underwriting and investment income. The objective was a taxing system substantially the same as that which has been applied to stock insurance companies other than life since 1921. In recognition of the quality of mutuality, however, two special deductions were allowed. One of these was dividends to policyholders; the other, surplus apportioned to policyholders. The latter was found to involve concepts generally novel to the business of writing insurance. Dividends to policyholders, moreover, were deductible only to the extent they were paid out of premiums received or surplus apportioned to policyholders; to the extent they were paid out of investment income, they were disallowed. For the purpose of determining their deductibility, dividends were assumed to be paid out of investment income to the extent of such income remaining after the deduction of the tax allowable thereto.

''Your committee carefully considered the house bill plan and various modifications of it in attempting to define and tax underwriting income in an equitable manner. No adequate method to accomplish that result was developed.

"The committee bill, therefore, proposes to tax mutual insurance companies other than life or marine upon that one of the following two bases which produces the greater tax. One of these bases is net investment income, to which are applied the rates applicable to corporate incomes generally. The other base is the gross amount of income from interest, dividends, rents and net premiums, less dividends to policyholders and wholly tax-exempt interest. To this base the rate of 1 per cent is to apply. Mutual marine insurance companies are taxable under the provisions applicable to stock insurance companies other than life. This is essentially the basis upon which they are taxed under existing law. Reciprocal underwriters and interinsurers are subject to the net investment income tax and not to the 1 per cent tax.

"It is believed that the plan of taxation recommended by your committee will operate much more equitably than the House bill plan, or any modification thereof incorporating the principle of taxing underwriting income, and will have no regulatory effect upon the industry. At the same time, it offers no unusual administrative difficulties and will yield a considerable amount of revenue."

Senate Finance Committee, Senate Report No. 1631, Seventy-seventh Congress, Second Session Calendar No. 1683 (October 2, 1942).

APPENDIX No. XV

REVENUE ACT OF 1917

"Title V.—WAR TAX ON FACILITIES FURNISHED BY PUBLIC UTILITIES AND INSURANCE.

"Sec. 504. That from and after the first day of November, nineteen hundred and seventeen, there shall be levied, assessed, collected, and paid the following taxes on issuance of insurance policies:

"(a) Life insurance: * * *

"(b) Marine, inland, and fire insurance: A tax equivalent to 1 cent on each dollar or fractional part thereof of the premium charged under each policy of insurance or other instrument by whatever name the same is called whereby insurance is made or renewed upon property of any description (including rents or profits), whether against peril by sea or inland waters, or by fire, lightning, or other peril: Provided, That policies of reinsurance shall be exempt from the tax imposed by this subdivision;

"(c) Casualty insurance: * * *."

APPENDIX No. XVI

REVENUE ACT OF 1918

"Title V. — TAX ON TRANSPORTATION AND OTHER FACILITIES, AND ON INSURANCE.

"Sec. 503. That from and after April 1, 1919, there shall be levied, assessed, collected, and paid, in lieu of the taxes imposed by section 504 of the Revenue Act of 1917, the following taxes on the issuance of insurance policies, including, in the case of policies issued outside of the United States (except those taxable under subdivision 15 of Schedule A of title XI), their delivery within the United States by any agent or broker, whether acting for the insurer or the insured; such taxes to be paid by the insurer, or by such agent or broker:

"(a) Life insurance: * * *"

"(b) Marine, inland, and fire insurance: A tax equivalent to 1 cent on each dollar or fractional part thereof of the premium charged under each policy of insurance or other instrument by whatever name the same is called whereby insurance is made or renewed upon property of any description (including rents or profits), whether against peril by sea or inland waters, or by fire or lightning, or other peril;

"(c) Casualty insurance: * * *."

APPENDIX XVII

(Prior to 1942 amendment)

"EXEMPTIONS FROM TAX ON CORPORATIONS.

"Sec. 101. The following organizations shall be exempt from taxation under this chapter:

"(11) Farmers' or other mutual hail, cyclone, casualty, or fire insurance companies or associations (including interinsurers and reciprocal underwriters) the income of which is used or held for the purpose of paying losses or expenses."

APPENDIX No. XVIII

(Subsequent to 1942 amendment)

"EXEMPTIONS FROM TAX ON CORPORATIONS.

"Sec. 101 (Internal Revenue Code). The following organizations shall be exempt from taxation under this chapter: * * *

"(11) Mutual insurance companies or associations other than life or marine (including interinsurers and reciprocal underwriters) if the gross amount received during the taxable year from interest, dividends, rents and premiums (including deposits and assessments) does not exceed $75,000; * * *"

APPENDIX No. XIX

	By United States		By Dominion of Canada	
	Mutual Insurance Companies	*Stock Insurance Companies*	*Mutual Insurance Companies*	*Stock Insurance Companies*
1917-1920:				
Subject to Income Tax....	No	Yes	No	Yes
Subject to Premium Tax...	Yes	Yes	Yes(1)	Yes(1)
1921-1941:				
Subject to Income Tax....	No	Yes	No	Yes
Subject to Premium Tax...	No	No	Yes(1)	Yes(1)(2)
1942-1946:				
Subject to Income Tax....	Yes(3)	Yes	No	Yes
Subject to Premium Tax...	No	No	Yes(4)	Yes(5)
1946 to present:				
Subject to Income Tax....	Yes(3)	Yes	Yes	Yes
Subject to Premium Tax...	No	No	Yes(5)	Yes(5)

[1]at rate of 1% (collection suspended from Dec. 31, '28 to Jan. 1 '32).

[2]Deductible from amount of Income Tax otherwise payable.

[3]On one of two bases (1) investment income at corporate rates or (2) net premiums, plus gross investment income at 1%.

[4]At rate of 3% and 4% of net premiums.

[5]At rate of 2%.

APPENDIX No. XX

Construing the foreign tax credit provisions of the Revenue Acts from 1917 to 1942, the Commissioner ruled that the foreign tax should be allowed as credit in the following:

I. T. 1522, I-2 C.B. 199 (Rev. Acts '18 and '21)Cuban tax;

I. T. 2070, III-2 C.B. 250 (Rev. Acts '21 and '24) Bolivian tax Mining Profits;

I. T. 2118, III-2 C.B. 251 (Rev. Acts '21 and '24) Puerto Rican Income tax;

G.C.M. 6042, VIII-1 C.B. 184 (Rev. Act '22) Chilean tax on Profits;

G.C.M. 800, V-2 C.B. 75 (Rev. Act '22) Brazilian tax on Gross Income;

G.C.M. 7629, IX-1 C.B. 146 (Rev. Act '28) Cuban "net profit" tax;

I. T. 2445, VIII-1 C.B. 102 (Rev. Act '28) Ecuador tax;

I. T. 2762, XIII-1 C.B. 64 (Rev. Act '32) Argentine Dividend tax;

I. T. 3313, 1939-2 C.B. 171 (Rev. Act '32) Brazilian Profits tax;

I. T. 2964, XV-1 C.B. 138 (Rev. Act '36) Canada tax on Copy Right use;

G.C.M. 14625, XIV-1 C.B. 114 (Rev. Act '36) Mexican Absenteeism tax;

I. T. 3171, 1938-1 C.B. 192 (Rev. Act '36) English Profits tax;

G.C.M. 21227, 1939-1 C.B. 191 (Rev. Act '36) Canadian Dividend tax; (Part 1)

I. T. 3371, 1940-1 C.B. 102 (Rev. Act '36) Netherlands Profits tax;

I. T. 3385, 1940-1 C.B. 103 (Rev. Acts '36 and '38) Mexican Dividend tax;

I. T. 3464, 1941-1 C.B. 257 (Rev. Act '41) Canadian Net Income tax.

APPENDIX No. XXI

Construing the foreign tax credit provisions of the Revenue Acts from 1917 to 1942, the Commissioner ruled that the foreign tax should be denied as a credit in the following:

O. D. 372, 2 C.B. 115 (Rev. Act '17) Cuban tax on Sugar Produced;

I. T. 2499, VIII-2 C.B. 325 (Rev. Act '18) Peruvian Sugar Export tax;

I. T. 1444, I-2 C.B. 168 (Rev. Act '21) Latvian tax on Living Expenses;

G.C.M. 8478, IX-2 C.B. 224 (Rev. Act '26) French Transfer tax;

I. T. 2596, X-2 C.B. 184 (Rev. Act '28) Cuban tax on Gross Revenues;

G.C.M. 11039, X-2 C.B. 118 (Rev. Act '28) Film Hire tax;

I. T. 3040, 1937-1 C.B. 109 (Rev. Act '36) Mexican tax on capital export;

I. T. 3138, 1937-2 C.B. 230 (Rev. Acts '32 and '34) Canadian Net Premium tax;

I. T. 3211, 1938-2 C.B. 177 (Rev. Acts '34 and '36) Net Premium tax by Canadian Provinces;

I. T. 2909, XIV-2 C.B. 136 (Rev. Act '34) Quebec Mining Profits tax;

I. T. 3429, 1940-2 C.B. 136 (Rev. Act '40) Cuban Gross Receipts;

I. T. 3433, 1940-2 C.B. 137 (Rev. Act '40) Cuban Mineral Fuel tax.

APPENDIX No. XXII

Construing Section 131 of the Internal Revenue Code from the enactment of the 1942 amendment to date, the Commissioner ruled that the foreign tax should be allowed in the following:

I. T. 3565, 1942-2, C.B. 135 (1942) Cuban tax on Salaries and Wages;

I. T. 3683, 1944, C.B. 290 (1944) Mexican tax on Dividends;

I. T. 3774, 1945, C.B. 204 (1945) Tax on Net Profits;

I. T. 3778, 1946-1, C.B. 11 (1946) Tax on Net Profits;

I. T. 3837, 1947-1, C.B. 56 (1947) Argentine Income and Profit tax;

I. T. 3903, 1948-8, C.B. 5 (1948) Cuban Gross Revenue tax.

APPENDIX No. XXIII

Construing the foreign tax credit provisions of U. S. Revenue Acts prior to 1942 the following decisions held that the foreign tax *should be* allowed as a foreign tax credit:

Herbert Ide Kien v. Commissioner (1929) 15 B.T.A. 1243.....	French income tax
Havana Electric Ry. Light & Power Co. v. Commissioner (1936) 34 B.T.A. 782..	Cuban net profit tax
Seatrain Lines, Inc. v. Commissioner (1942) 46 B.T.A. 1076.....	Gross revenue tax
Santa Eulalia Mining Co. v. Commissioner (1943) 2 T.C. 241.....	Gross revenue tax
Queen Insurance Company of America v. Commissioner (August 18, 1939) 40 B.T.A. 484(1)	Canadian income and premium taxes.
Continental Insurance Co. v. Commissioner (Sept. 9, 1939) 40 B.T.A. 540(2).	Canadian income and premium taxes.

(1) Overruled by *Helvering v. Queen Ins. Co.* (1940) 115 F.(2d) 341, 25 A.F.T.R. 996.

(2) Part of decision overruled by *Helvering v. Queen Ins. Co., supra,* part of decision affirmed by District Court in *St. Paul Fire & Marine Insurance Co. v. Reynolds* (1942) 44 F. Supp. 863, 29 A.F.T.R. 592.

APPENDIX No. XXIV

Construing the foreign tax credit provisions of the U. S. Revenue Acts prior to 1942 the following decisions held that the foreign tax *should not be* allowed as a foreign tax credit:

Eitingon-Schild Co. Inc. and Subsidiaries v. Commissioner (1931) 21 B.T.A. 1163. French turnover tax.

Havana Elec. Ry. Light & Power Co. v. Commissioner (1934) 29 B.T.A. 1151.. Cuban tax on doing business.

Mallouck et al. v. Commissioner (1936) 34 B.T.A. 269..... Philippine Island privilege tax.

New York & Honduras Rosario Mining Co. v. Commissioner (1947) 8 T.C. 1232(4).. Profits tax on mine exploitation.

Keasbey and Mattison Co. v. Rothensies (1943) 133 F.(2d) 894, 30 A.F.T.R. 990. Profits tax on mining.

Helvering v. Queen Insurance Co. (1940) 115 F.(2d) 341, 25 A.F.T.R. 996(1).... Canadian income and premium tax.

Continental Insurance Co. v. Commissioner (Sept 9, 1939) 40 B.T.A. 540(2).... Canadian premium tax.

St. Paul Fire & Marine Insurance Co. v. Reynolds (1942) 44 F. Supp. 863(3), 29 A.F.T.R. 592..... Canadian premium tax.

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[1]Overruling B.T.A. decision in *Queen Insurance Co. v. Commissioner* (1939) 40 B.T.A. 484.

[2]Partly affirmed in *St. Paul Fire & Marine Insurance Co. v. Reynolds, supra.*

[3]District Court affirmed decision of B.T.A. in *Continental Insurance Co. v. Commissioner* (1939) 40 B.T.A. 540.

[4]Tax Court decision overruled by U. S. Court of Appeals in 168 F. (2d) 745, 36 A. F. T. 1115.

APPENDIX XXV

In the House of Commons Debates on August 2nd, 1946, the Honorable Douglas Abbott (Acting Minister of Finance), in presenting the proposed 1946 amendment to the Special War Revenue Act stated as follows:

"I have a brief explanation to give here, and in a moment I shall ask one of my colleagues to move an amendment. These resolutions are related to resolution fourteen under the Income War Tax Act, under which it is proposed to withdraw the exemption from income tax at present applying to mutual insurance companies other than life insurance companies. The removal of this exemption from income tax is in accordance with the recommendation of the McDougall commission. *In view of the fact that these mutual insurance companies will no longer be completely exempt from tax, a reduction is being proposed in the premium taxes under the Special War Revenue Act applying to these companies.* (Italics ours)

"The amendments to resolutions 4 and 5 which I shall ask one of my colleagues to move are the result of further consideration of premium taxes since the budget was introduced. I had a large number of representations on this point, including representations from the hon. member for Stanstead who is unable to be here this afternoon. What is being proposed now can be summed up in three statements. First, the base on which premium taxes will be levied in future will be uniform for all classes of insurers, and the basis will be net premiums as distinct from gross premiums. Second, there will be a uniform rate of two per cent applying to all classes of insurers with two exceptions; third, the two exceptions are insurers under Lloyds and reciprocal insurers otherwise known as exchanges. These two *classes, it is believed, will not be subject to corporation income tax in Canada, and because of this fact the premium tax in their case will be three per cent in place of the general two per cent.* I will ask

my colleague, the Minister of National Revenue, to move an amendment to resolutions 4 and 5 * * *." Dominion of Canada, official Report of Debates House of Commons, second session—Twentieth Parliament—10 George VI, 1946, Vol. IV, 1946, Friday, August 2, 1946, page 4244. (Italics ours)

Referring to the proposed imposition of the tax on farm mutuals the Honorable Mr. Abbott stated as follows:

"I agree that farm mutuals do perform a service and have a type of insurance which most of the stock and other companies are not anxious to take. But there is no real difference in principle or practice between the service they are rendering to their members and that found in a cooperative organization. I do not agree with the hon. member when he says that the tax here is a serious matter. *The heavy and the important tax in connection with ALL these mutuals is the premium tax; there is no doubt about that* * * *." (Emphasis supplied). Dominion of Canada, official Report of Debates House of Commons, second session, Twentieth Parliament, 10 George VI, 1946, Vol. V, 1946, Tuesday, August 13, 1946, pages 4735, 4736.

On the same date the Honorable Mr. Abbott, referring to the general writing mutuals as well as the farm mutuals, stated as follows:

"The McDougall commission reported that these mutuals (*cash premium mutuals*) should be put on the same basis as other cooperatives. They did suggest, in the case of farm mutuals more than fifty per cent of whose business was insuring farm property, exemption from taxation. The commission says on page 65 (Italicized portion inserted):

" 'We are of the opinion that mutuals can and do have income which is subject to tax. This income results from investments and operating gains which are free from claims of policyholders. At the same time we consider that mutuals in certain specialized fields are

rendering a service which is not provided by other organizations, notably, in insuring farm and other unprotected rural risks. These mutuals tend to keep their rates as low as is consistent with the risk involved. We consider that it would not be in the public interest to impose income tax upon those insurers whose activities are primarily in these fields.'

"They recommended that if more than fifty per cent of the business was in insuring farm property they should be exempt. That was considered by the minister and his advisers, and it was felt that we should not single out a special class of insurance companies for complete exemption. *This particular class already receives special treatment by exemption from the premium tax, which is the important tax in this field* * * *." (Italics ours). Dominion of Canada, official Report of Debates of House of Commons, second session—Twentieth Parliament, 10 George VI, 1946, Vol. V, 1946, Tuesday, August 13, 1946, page 4738.

The following quotations are taken from debates of the Senate of the Dominion of Canada, 1946, official Report, Second Session—20th Parliament—10 George VI, at the end of each quotation is an appropriate reference to the date and page.

On August 15, 1946, the Honorable Mr. Hayden, who presented to the Senate the proposed amendments to the Canadian Special War Revenue Act, stated as follows:

"* * * * * * * * * *

"The first amendment provides for a change in the definition of 'net premiums.' As honourable senators know, the Special War Revenue Act provides for a tax upon premiums received by insurance companies. Up to this year mutual insurance companies in Canada have paid no income tax, and this situation will continue until the amendments to the Income Tax Act are ratified. *The mutual insurance companies were*

reached through the medium of a tax on premiums. * * *." Page 645 (Italics ours)

The Honorable W. D. Euler, in 1946, was chairman of the Canadian Senate Committee on Taxation. In debating the amendment to the Canadian Income War Tax Act on August 29, 1946, the Honorable Mr. W. D. Euler stated as follows:

"* * * * * * * * * *

"These small companies—mostly mutual companies doing fire, casualty and other insurance—do not for one moment object to being taxed on their profits. I would like honourable senators to bear in mind that while these companies have been so far subject to a tax on their premiums only and have paid no income tax at all, they never thought that was a right procedure. They have always felt that they should be subject to income tax on their profits, just as any other business concern is, but because *the tax on premiums was practically the same in amount as the income tax would have been,* they raised no particular objection. * * *." (Italics ours). August 29, 1946, page 762.

APPENDIX No. XXVI

The following quotations contain those subsections of the Special War Revenue Act of 1942 providing penalties for failure to pay the tax or file returns as provided. The quotations are of subsection 20 and 21, Part III, Chapter 179, R.S. 1927, page 8:

20. 1. Every company to which section fourteen or section fifteen of this Act applies which refuses or neglects or whose chief agent or attorney, as the case may be, refuses or neglects to make any return as required by this Part shall be liable to a penalty not exceeding fifty dollars for each and every day during which such refusal or neglect continues.

2. Every president, vice-president, managing direc-

tor, secretary, officer, clerk or servant, agent or attorney of such company, who willfully makes a false or deceptive statement in the return aforesaid or in any of the books and records of the company from which such return is compiled, shall be guilty of an indictable offence punishable, unless a greater punishment is in any case by law prescribed therefor, by imprisonment for a term not exceeding five years.

3. Every president, vice-president, managing director, secretary, officer, clerk or servant, agent or attorney of such company, who negligently prepares or signs a return or record of the company containing a false or deceptive statement or who negligently makes an untrue entry in the books of the company affecting the correctness of the return shall be guilty of an indictable offence punishable, unless a greater punishment is in any case by law prescribed therefor, by imprisonment for a term not exceeding three years.

21. Every person who fails or neglects to make the return required by section eighteen of this Act, or to pay to the Minister within the time limited by section sixteen of this Act, the tax thereby imposed, shall incur a penalty of fifty dollars for each and every day during which such default continues. 1932, c. 54, s. 1; 1942, c. 32, s. 8.